Everybody Entertainment

VHQ™

2001 Annual Report

VHQ doesn't merely sell movies, music and games. We sell celebrations of living – all of the laughter, tears, adventure and romance that has moved us as a people to cheer, to dance, to dream. To our customers, we are, and always will be, a destination for the imagination.

Mission

VHQ's mission is to be the retail destination of choice for diverse home entertainment in a digital world.

VHQ is a destination for customers seeking home entertainment, both online and in community-based retail stores. Growing from its solid base in the video retail market, VHQ is expanding its geographic reach, its product mix and its technology to become a primary destination for home entertainment.

The future of VHQ is as an aggregator of home entertainment software, hardware, content and merchandise. Consumers who are in the habit of coming to VHQ for movie, music and game rentals or purchases will make a comfortable transition to visiting VHQ (online or in person) for developing multimedia entertainment software and hardware platforms designed to give them access to the ever-evolving and expanding world of home entertainment.

VHQ is connected to its proven retail market, connected to key producers of entertainment content and connected to the global e-marketplace. VHQ is committed to staying in touch with the people who create content, the people who enjoy it as consumers and the technology that brings them all together.

For the millions who enjoy home entertainment, VHQ is an integrated and diverse retail presence offering unparalleled selection, service and value.

For investors, VHQ is the model of a successful retailer positioned for even greater success in the new economy of the 21st century.

Contents

Profile

VHQ Entertainment Inc. ("VHQ") is a dynamic and rapidly growing video and home entertainment retailer. VHQ's mission is to become the retail destination of choice for diverse home entertainment in a digital world.

With 45 company-owned retail locations operating as at May 31, 2001, VHQ plans to continue its strategic expansion – a plan that, over the next five years, calls for VHQ to become a leading national retailer in its field. VHQ strives to offer its customers the best selection of quality home entertainment including DVD, video, CD music, entertainment and gaming related magazines and video games on all major platforms.

Complementing its wide selection of entertainment software, VHQ plans to add the latest entertainment hardware as well – a step that will make VHQ a single stop destination for "Everything Entertainment." VHQ's retail stores are located in major urban centers and widely throughout many rural communities where the consistency of our product offering ensures the best and latest selection of products for all of our customers.

VHQ Entertainment – Where Entertainment Begins!™

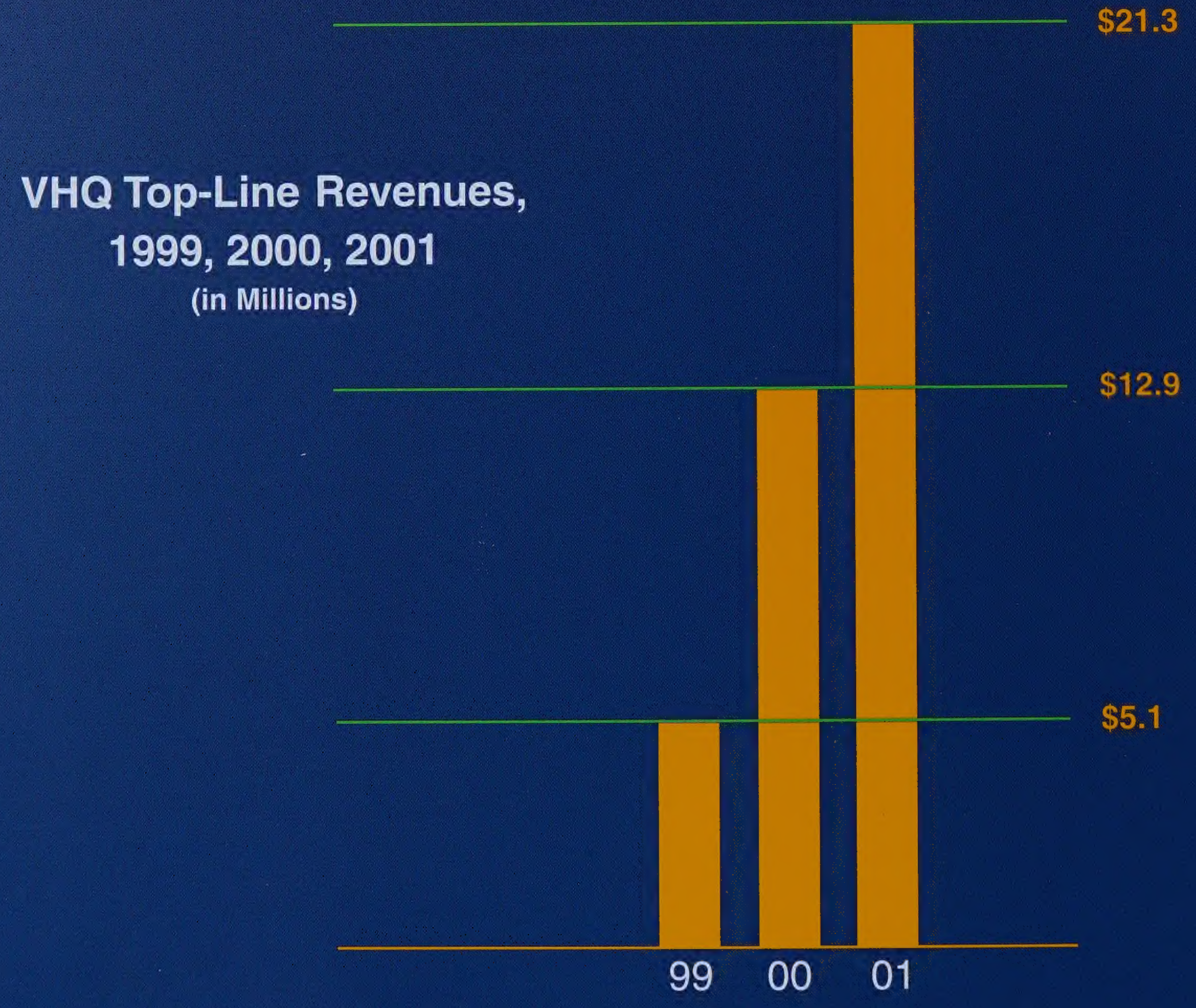
VHQ Entertainment Inc. is a public company listed on the Toronto Stock Exchange, trading under the symbol "VHQ".

Contents

We know who drives our business. Our neighbours, our friends, our customers. The people who crowd the aisles of our stores, seeking thrills, emotion and adventure. They span age, race and gender. They are involved and informed, yet curious about the world outside their doors. They are connected – both to their communities and to the digital world. They're smart, they're savvy, and they seek endless opportunities to express their individuality.

This is Everybody Entertainment, and these are our customers. We know them well.

Over the past three years, VHQ has grown from a concept to a thriving business employing over 400 people, all the while consistently delivering profitable results from operations.



Vision

"With all of our past accomplishments and successes to reinforce us, as a company we look forward to each new day, understanding that the best is yet to come."

Rod D. Stephen
Chairman of the Board

Over the past three years, VHQ has grown from a concept to a thriving business employing over 400 people, all the while consistently delivering profitable results from operations.

Free Movie Rental

This coupon is valid at a VHQ location near you.

Not valid with any other offers. Expires September 1, 2002.

Vision

Our guiding principles are evident in our success: a commitment to hard work and a passion for what we do. As we move forward and enjoy the opportunities of the coming year, we are confident that the loyalty and enthusiasm of our customers, staff and shareholders more than equal any challenges that may lie ahead.

At VHQ Entertainment we value this opportunity to share our story with you and believe this letter must be more than simply an explanation of our financial results. It is an opportunity to review our performance against our business strategy, to discuss the vision we have for this Company and to enumerate the steps we need to take in order to achieve our future goals.

Last year we announced some key objectives that we believed needed to be accomplished in 2001:

- We told you that we would seek a listing on the Toronto Stock Exchange in an effort to ensure greater market visibility and the access to capital markets that is necessary for the expansion of our retail presence across Canada and beyond. On July 24, 2001, we were pleased to achieve this milestone when our shares commenced trading on the TSE that day.
- We believed it was vital to rename and re-brand our Company (formerly "Video Headquarters Inc.") as VHQ Entertainment Inc. in an effort to better reflect the depth and variety of our entertainment merchandise offerings. On December 6, 2000, our name was officially changed to reflect this new positioning. All newly built VHQ retail locations have been opened under the VHQ Entertainment banner.
- We announced that we would dedicate ourselves to further boosting sales and same store sales growth. We began by addressing the marketing, merchandising and branding of VHQ stores to reinforce our position as the best-in-class source for movies, music, games and entertainment-related merchandise. We made our stores more appealing with clean and fresh styling, and forged strategic relationships with other retailers who in the future will enable us to further diversify our merchandise mix, especially in our rural and smaller-urban markets. As a result of these initiatives, same-store sales are on the rise and consumers have told us that our new look and product mix have transformed VHQ from a local home video rental store to a destination they are prepared to look to for "everything entertainment™".

Although the above accomplishments translate into a solid performance in 2001, we recognize that this past year represented just the beginning of VHQ's ongoing renewal. It laid the foundation for the continued growth of our business and reenergized and realigned our workforce and our brand.

All told, we've successfully reinvented ourselves – from a video rental chain to a preferred provider of all things entertainment. As we continue to execute our growth and diversification strategy, we are confident that our visibility will increase, our brand will become a recognized leader in the marketplace and our reputation for delivering high-quality entertainment will continue to spread.

In subsequent sections of this report, you will be made aware of exciting new industry developments in the film, gaming and music industries – developments that we as a company celebrate and are confident will carry us forward. You will read of our commitment to supply a diverse range of home entertainment software and hardware to a growing number of consumers, made possible through an integration of physical stores and online environments, as well as by our embrace of new and converging entertainment technology.

Fiscal 2001 - Looking Back

Over the course of fiscal 2001, VHQ reaffirmed its goal of becoming an all-in-one entertainment content provider, focused on embracing digital technology, providing entertainment merchandise suited to the diverse interests of each individual customer, and on delivering exceptional shareholder value. We have expanded our geographic reach, our product mix and our technology, and in doing so have also exceeded our sales projections for the third consecutive year

To recap another year of strong performance:

- VHQ revenues for the year totaled $21.3 million. This figure, when compared to the $12.9 million in revenues recorded at year end in May 2000, depicts an impressive increase of 65.5 percent over fiscal 2000's results.
- Our store count grew from 33 to 45 retail locations, to reflect a 36 percent increase over fiscal 2000.
- Our chain-wide same store sales grew by an average of 17 percent, more than double the national retail average of seven percent.
- We continued to diversify and grow our revenue streams, with our shift from a home video rental chain to an all encompassing one-stop entertainment retail chain.

Today, VHQ store counts have dramatically increased our presence, fueled in part by our rising popularity with home entertainment consumers and the communities they live in. Through our sponsorship of a wide range of sports programs, community events and local initiatives, VHQ stores are giving something back to their communities, generating awareness and gaining loyal, high-yield customers in the process.

We have grown to employ a staff of over 400 dedicated, knowledgeable people, versed in all aspects of our business. The value of our employees cannot be understated – their expertise and helpful demeanor maintain an impressive annualized same-store sales growth of 17 percent.

It is important to note that the entertainment industry itself continues to grow. The industry on the whole is flourishing, and this growth is at once a reflection of future trends combined with the present diversity of its consumers. As reflected in the theme of this report, the industry has evolved to a level where retailers must embrace the concept of "Everybody Entertainment", meaning that no two customers are alike in their needs, and yet they all share an insatiable thirst for entertainment that only grows with new developments in content, format and delivery.

Newly emerging hardware platforms, such as DVD technology, are experiencing rapid adoption as consumers flock to the latest innovation. VHQ was the first in the home entertainment industry to offer DVD rentals, and by being the first to market such innovations we are able to capture market share and naturally become the first choice for delivery of cutting-edge products to consumers with increasingly discerning tastes.

Fiscal 2002 - The Year Ahead

The opportunities for growth in fiscal 2002, through physical expansion of our retail presence and emerging opportunities within key merchandise categories in-store, give us every reason to believe that we can continue to post double-digit revenue growth. Doing so will require our steadfast attention to the fundamentals of our core business, even as we invest in new technologies and innovation critical to our future. These include delivering earnings growth, increasing total and comparable store sales, investing in the development of people and gaining market share, among others.

Our outlook is justifiably optimistic. The market for home entertainment is consistently developing, converging, and expanding. Consumers are spending more now than ever before on a much wider spectrum of entertainment media. Format-specific stores are losing ground to all-in-one content providers – and VHQ stores are setting the industry standard in this new climate.

Embracing this belief system throughout the organization, we are focusing our energy and resources on two primary strategic imperatives:

1.Continually improve retail execution throughout our business.

VHQ continues to create a customer-centered culture, where every behavior every day is linked to better satisfying and better serving the customers who shop with us. Ultimately, our primary measure for evaluating customer satisfaction will be higher customer spending per visit. Management is confident that successfully accomplishing this goal will result in even higher same store sales across our chain.

To support this goal, we must do what it takes to create the conditions and the motivation to sell more in an environment that delivers more to our customers. To this end, our core merchandising strategy will focus on constant delivery of differentiation and value. Over the course of fiscal 2002, we are dedicated to improving the quality of our stores, of our merchandising and point-of-purchase presentations, and of our complete product assortment. Across every store in our chain, we will create a sense of excitement and entertainment that will prove to customers and staff that VHQ is truly "Where Entertainment Begins"™.

2. Aggressively pursue sales, marketing and branding opportunities to define a distinct market position designed to clearly differentiate VHQ from our competitors.

As we continue our strategic growth plan that calls for VHQ to physically expand into new jurisdictions and double the size of our chain in the near-term, we recognize the importance of supporting our physical presence with a caliber and frequency of marketing communications that keeps us top-of-mind in the marketplace. Increased public awareness of the new VHQ brand has already fueled remarkable growth in all categories of our business – from movies, to games, to music and beyond. Mainstream acceptance of our new brand has propelled us forward into a new period of growth and development, as we endeavor to provide all things entertainment for an increasingly technology-savvy market of customers.

In 2002, we are committed to generating even greater consumer awareness of our products and increased sales to our retail customers. We will accomplish this by investing in a new brand campaign which represents our most sweeping, regionally executed marketing program ever, encompassing outdoor, print, and broadcast media, point of sale, the Internet and consumer promotions.

Our mandate in the year ahead is to create sustainable growth that profitably leverages all of the core strengths of the Company. Our progress to date reflects our transition from start-up to success, and embodies the support we enjoy from our customers, shareholders, suppliers, employees and the communities we serve. In every pursuit, we will be guided by our vast retail experience, knowing that customer satisfaction is synonymous with creating shareholder value.

Acknowledgements

It would be impossible to tell the story of our continued growth without recognizing the extraordinary efforts of our employees. From retail customer service staff to upper management, the entire VHQ team is dedicated to the continued success of our company. We commend each of them, and recognize their vital contribution to our ongoing achievements.

To our loyal shareholders, whose confidence has allowed and encouraged the growth and prosperity of this company, we thank you for your ongoing support – and we welcome you to the latest, greatest chapter of the VHQ experience. We are confident that our organization is capable of executing our 2002 business plans and delivering improved financial results for our shareholders. We look forward to sharing our continued success with you in the future.

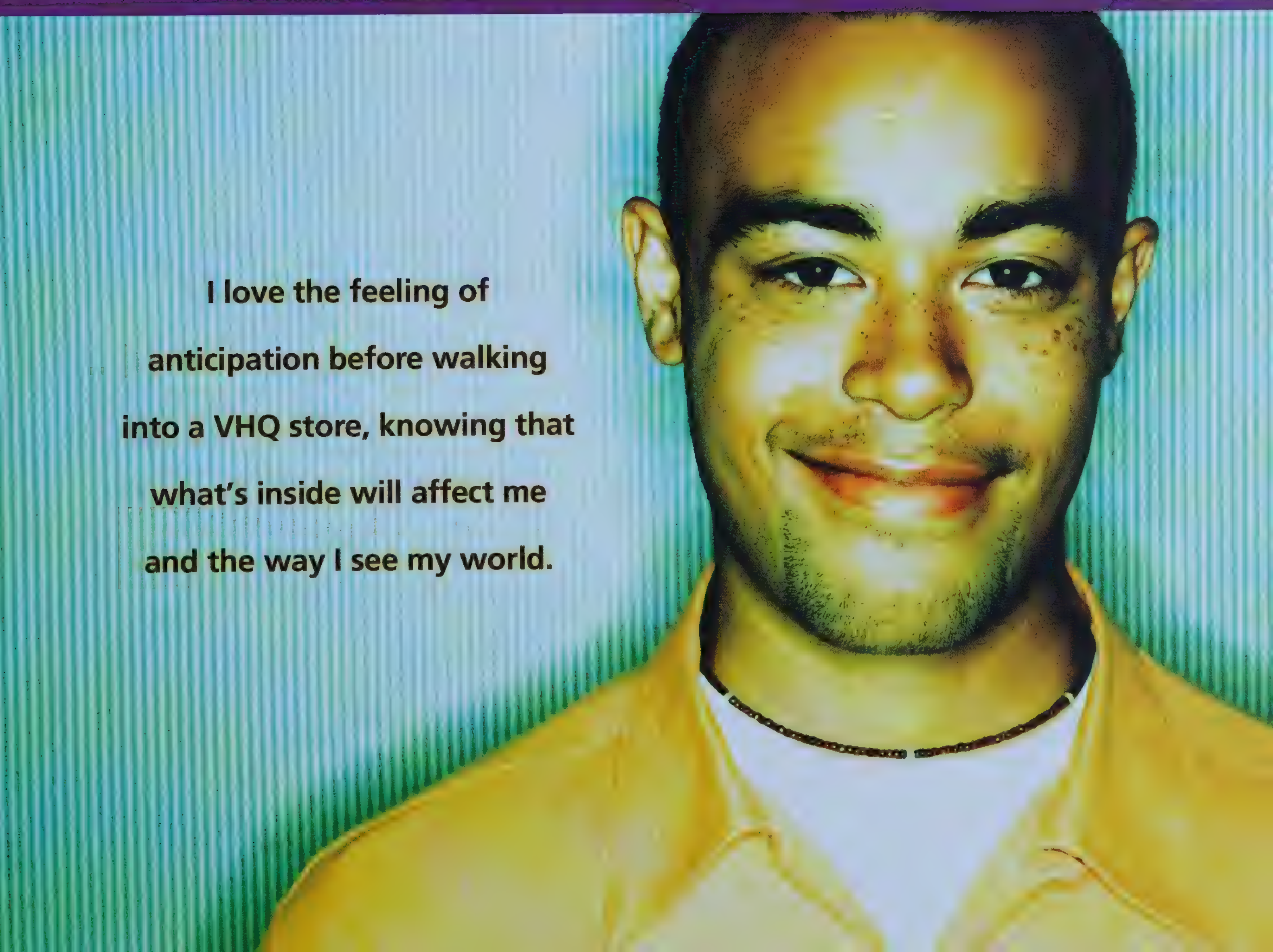
Sincerely,

Rod D. Stephen
Chairman of the Board
VHQ Entertainment Inc.

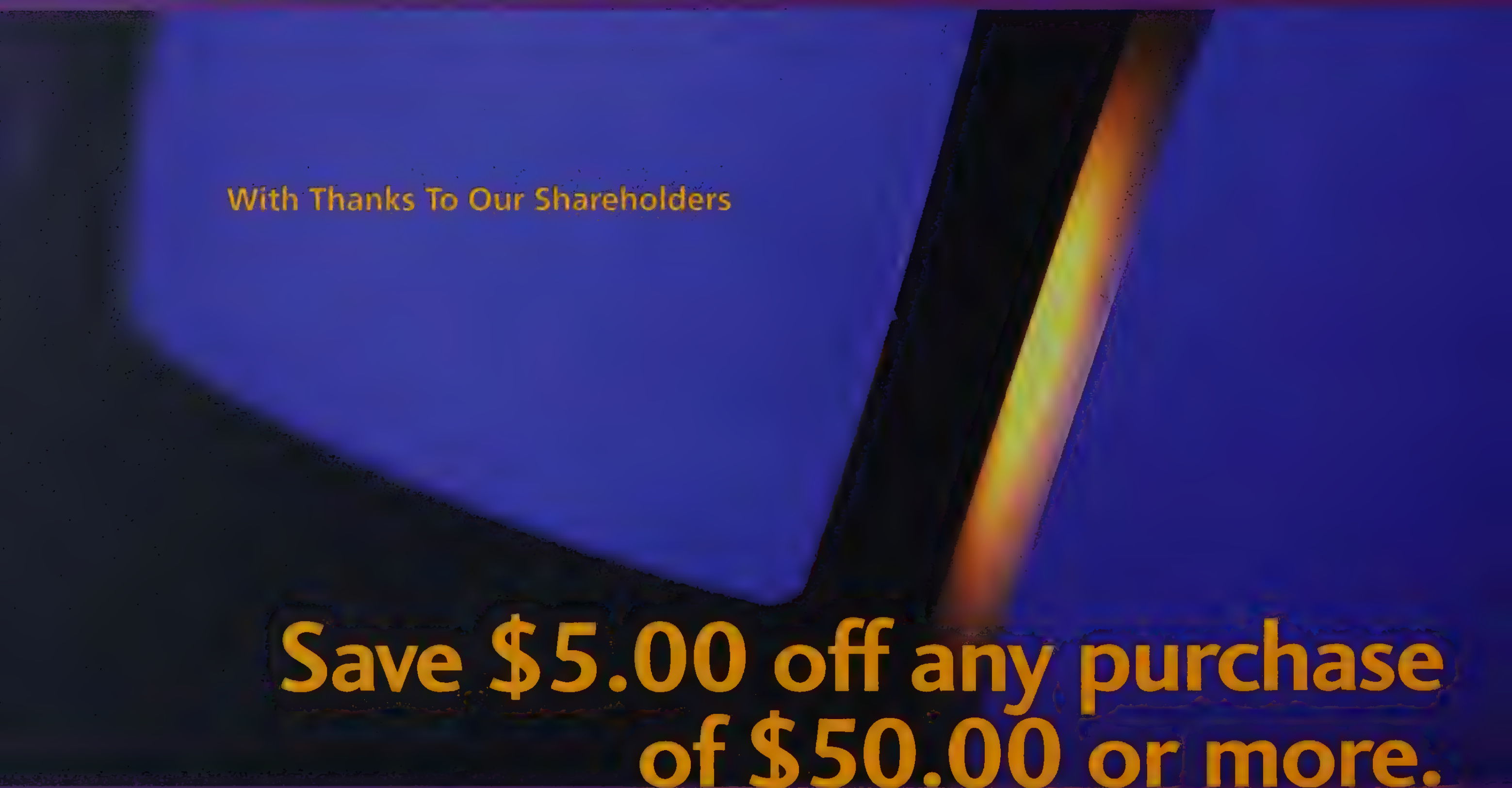
VHQ successfully completed more than 2,000,000 store sales transactions during fiscal 2001.

VHQ Number of Employees
1999, 2000, 2001

Brand


I love the feeling of anticipation before walking into a VHQ store, knowing that what's inside will affect me and the way I see my world.

VHQ successfully completed more than 2,000,000 store sales transactions during fiscal 2001.



This coupon is valid at a VHQ location near you.

VHQ

Not valid with any other offers. Expires September 1, 2002.

Brand

Above all, we understand that our brand is an investment that will grow over time, along with our company. To be better attuned to our customers, we have tailored our product offerings to meet their wants and needs. We've studied the lifestyle preferences that guide their purchases, and we've filled our stores with the items they're seeking. Today, our distinctive retail stores represent an ever-expanding opportunity for our customers to see, feel and share in the VHQ experience.

At VHQ, we understand that our continued success depends on clearly defined brand strategies, flawless in-store execution, a commitment to constant innovation, the support of our communities, and above all, the ability to truly know our customers and anticipate their wants and needs.

Satisfying the diverse entertainment cravings of our customers has always been our top priority. Today's 33-year-old is just as likely to purchase a video game as a 12-year-old. As each of our customers, and our culture in general, becomes increasingly techno-savvy, demographics are shifting across the board, with a wider age group interested in a wider spectrum of media. Whether VHS, DVD, a game or an audio CD is preferred, current media trends are yielding more information about our market than any traditional consumer profile ever could.

The world of digital entertainment and the Internet has opened the door to limitless entertainment choices, all available to be enjoyed from the comfort of one's own home. And with the average workweek steadily increasing, more people are nesting than ever before – a fact that is supported by dramatic increases in home entertainment purchases and the rising popularity of DVD and home entertainment systems.

Our customers are embracing new technology faster than anyone thought possible. Consequently, many large video store chains are in the midst of an "identity crisis". As new developments in entertainment technology are made available to the public, the majority of our competitors find themselves unprepared, under funded, and poorly positioned to accept these changes as they emerge.

Rather than carve out our own small niche of the entertainment sector, VHQ chose to embrace these developments, pursuing diversification over format-specific entertainment retail. In doing so, we anticipate the future wants and needs of consumers and take calculated risks that yield incredible results.

Building our Brand

Changing our name from "Video Headquarters" to VHQ Entertainment in fiscal 2000 signaled the beginning of a new era for our business.

As our market expanded, the mainstream populace was becoming progressively more interested in a diverse array of entertainment media. Our original brand had become somewhat antiquated, and was suggestive of only one *type* of media: VHS cassettes. Demand for DVDs, music, games, and accessories was on the rise, and management knew the Company would have to restructure quickly to take advantage of these new and potentially lucrative trends.

On December 6, 2000, we announced the launch of our new VHQ brand. More than just a new name, it was the birth of a dynamic corporate philosophy that has made us the fastest growing video and home entertainment retailer in Canada.

As a brand, VHQ means different things to different people. Some come for the movies, while others crowd our aisles for music, games, and merchandise. Our customers' tastes are as diverse as our product selection, and yet they are unified by a love of entertainment that transcends mere escapism.

Movies are sacred tomes of human experience – a captivating record of life's comedy and tragedy. Games give their fans chance to play the "hero" – to face immeasurable challenges and overcome them in noble fashion. Music is the perfect fusion of rhythm and harmony – without it, the pace of life would be dull at best.

On a corporate level, our new name reflects a company that's prepared to grow into every imaginable area of entertainment retail, rental and technology. To anticipate our customers' needs and to embrace these changes rather than resist them – these are the cornerstones of our business.

Our name has many meanings, but one holds true for employees and consumers alike: VHQ is truly "Where Entertainment Begins."™

The VHQ Experience

Our slogan, "Where Entertainment Begins,"™ is something that we want our customers to see, hear, and feel the moment they walk into any one of our stores.

From the moment they enter, we set out to engage our customers in a unique experience, full of limitless entertainment possibilities. A modern, welcoming environment, VHQ stores tempt the senses with a broad selection of *everything entertainment* – movies, music, games and merchandise, complemented by action-packed monitors and bold in-store signage.

Converting our stores continues to be a big step towards building lasting relationships with our customers - a catalyst for providing superior customer service at every stage of the VHQ experience.
Our friendly staff are required to stay current with the latest industry news, including new media developments that will have a positive impact on the future of entertainment delivery and

consumption. They are prepared to answer tough questions, make solid recommendations, and put the needs of the customer first. A complete knowledge of all VHQ products, services and specials is expected, and our staff consistently deliver.

The benefits of total customer satisfaction far outweigh the costs involved. Every night after 10:00 pm, VHQ's *Happy Hour* means customers rent two new releases for the price of one. We reward moviegoers with the same deal – an movie theatre box office ticket stub earns a free rental with any new release, any time of day. Rather than cut into our profits, these ongoing specials have increased our clientele, encouraged defections from competing chains and boosted our sales exponentially.

Since the Company's inception, these forward-thinking initiatives have set us apart from our competition. Eliminating the need for a membership card, our members each have a four-digit PIN number instead. This not only marks the end of lost and stolen cards – it speeds up the rental process to the point where long lineups and frustrated customers are a thing of the past.

As we move forward, an increasing number of our customers are becoming comfortable with Internet-based transactions. Through E-Trend Networks Inc., VHQ's online subsidiary, we've made seamless integration between our physical stores and the Internet a reality. This has further enhanced the shopping experience for our customers, increased brand awareness and allowed for a level of global reach that was previously unattainable.

Today, our customers have the opportunity to purchase movies, games, and music via VHQ.ca or EntertainMe.com and to return or exchange these items at any one of our stores. As one method of transaction invariably complements the other, we're tracking startling growth in both areas of our business.

Unprecedented Growth

In 2000, movies, music and games rose to well over $40 billion in combined North American sales alone – an astronomical figure that reflects the rising, consistent popularity of our industry. To keep up with our customers' growing demand for home entertainment, fiscal 2001 saw VHQ expanding our stores, our chain and our selection.

Our same-store sales growth continues to exceed retail-industry expectations, as we achieved a 17 percent annualized same-store sales growth in fiscal 2001. This is more than double the industry average of seven percent, and a clear indicator of our aggressive posture in this industry.

At the close of fiscal 1999, 14 stores were operating under the Video Headquarters trademark. In 2000, that number had more than doubled, to 33 stores running under the new and improved VHQ brand.

Today, the VHQ store count has risen to 45 stores – a 36 percent increase over last year, framed by aggressive plans to expand into central Canada and north-western U.S. markets.

Our expanding selection of movies, music and games plays a major role in the growth of our chain. Revenue-sharing deals with major studios have allowed us to stock more movies at a dramatically lower overhead cost, thus enabling guarantees on the availability of popular titles.

The addition of game and music sections to our stores has attracted a much larger clientele, increasing the opportunity to up-sell our entire product line to these customers. And as a growing number of consumers look to the Internet for their purchases, VHQ has poised itself to be a leader in the virtual marketplace as well.

The Future

Looking ahead, the opportunities for expansion and product diversification are endless.

As smaller, independent video chains collapse under the weight of the new market, VHQ finds itself in a unique position to purchase and modernize their stores.

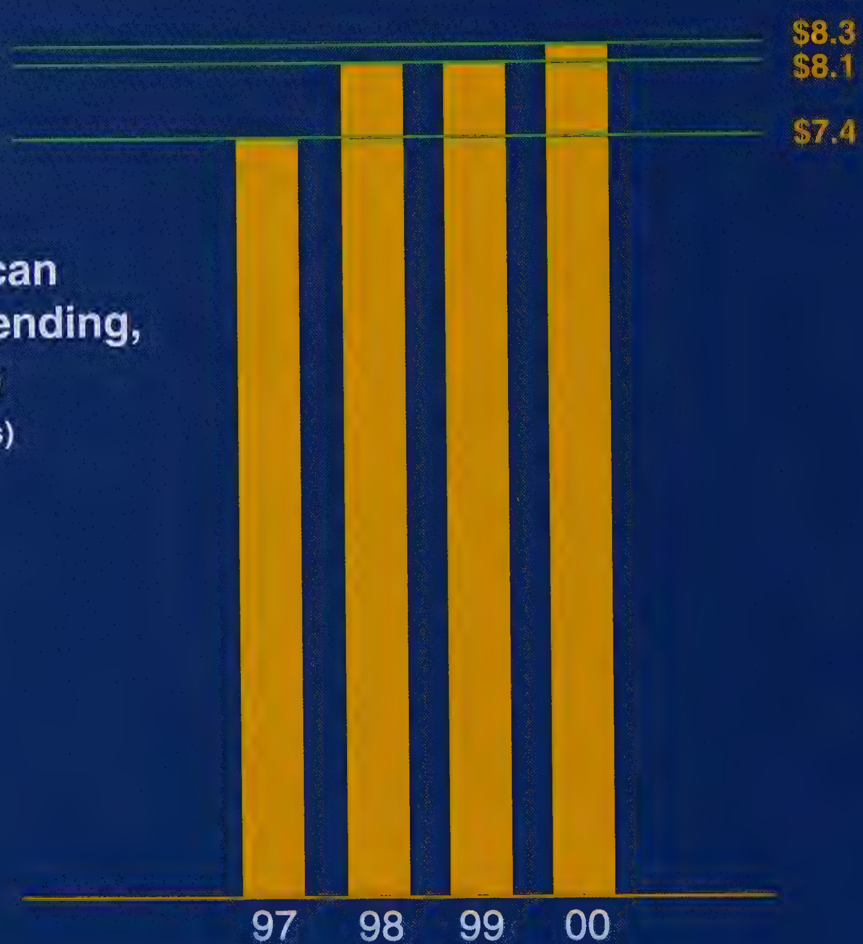
Soon, through the development of video-on-demand technology, consumers will have access to streaming broadband video sent directly to their homes. With the advent of HDTV, a television-Internet hybrid may emerge. Wireless technology will also offer many new and exciting opportunities for the consumer.

We will continue to prepare for the revenue opportunities right around the corner, and for other changes and opportunities well in advance – it is by doing so that we ensure a bright future for our customers, our investors, and ourselves.

"Rather than carve out our own small niche of the entertainment sector, VHQ chose to embrace these developments, pursuing diversification over format-specific entertainment retail. In doing so, we anticipate the future wants and needs of consumers and take calculated risks that yield incredible results."

One segment of VHQ's business, the video rental and sales business, generates close to 60 percent of the overall revenue of the movie industry and is therefore the largest studio revenue source – exceeding combined revenues from theatrical release, satellite, and pay-per-view.

North American
Movie Rental Spending,
1997-2000
(in US$ Billions)



Source: Video Software Dealers Association VidTrac Report, 2001

Movies

There's nothing like a good movie. I love the classics – Pokemon: The First Movie, The Little Vampire and Spy Kids. Hopefully, I'll be able to pass my love of film down to my own children someday.

One segment of VHQ's business, the video rental and sales business, generates close to 60 percent of the overall revenue of the movie industry and is therefore the largest studio revenue source – exceeding combined revenues from theatrical release, satellite, and pay-per-view.

Free Movie Rental

This coupon is valid at a VHQ location near you.

VHQ™

Not valid with any other offers. Expires September 1, 200[illegible]

Movies

People no longer merely crave entertainment, they depend on it. Films today define generations and reflect the attitudes and beliefs of our culture. At VHQ, delivering multi-formatted filmed entertainment allows us to do business in a digital world, with customers who demand new thinking, higher levels of creativity and more engaging ways of enjoying our products.

The market for filmed entertainment is a staggering one – transcending age, race, gender and economic status. The most widely adopted form of entertainment, the film industry continues to grow at an alarming rate.

What is often taken for granted, however, is the role that VHS and DVDs play in the overall picture. Deemed by many to be merely an offshoot of the business, profits garnered from the retail sale and rental of movies are, in reality, the determining factor behind any film's success and profitability.

This past year, rentals and sales for VHS and DVD hit an all-time high. The $20 billion mark was reached for the first time in the home rental industry's 20+ year history, and present indications suggest that similar results will follow for many years to come. These figures, when compared to a record $7.66 billion in box office receipts last year, serve to explain the reasons why home entertainment retailers like VHQ Entertainment command enormous respect and influence in the filmed entertainment industry - simply put, companies like ours are responsible for the bulk of its growth.

Our Audience

At VHQ, the rental and sale of VHS and DVD software continues to form the backbone of our business, and is chiefly responsible for our remarkable and industry-leading same-store sales growth of 16 percent.

Consumers have always maintained a love affair with movies, and their appetites consistently run the gamut of film genres, from Hollywood blockbusters all the way down to lesser-known "art films". Home viewing is still identified as the most convenient and reasonable means of watching movies – accounting for an ever-growing demand for films in both VHS and DVD formats.

All indicators suggest that demand for home entertainment will only continue to rise, as baby boomers pass the torch to their younger, media-hungry counterparts. This transition is already upon us and has proven integral to the rapid ascension of the now-mainstream DVD format, gaming consoles and new approaches to content delivery.

Rising Rentals

VHS and DVD rentals in North America have continued to rise, as indicated by a 9.2 percent increase in rental spending in 2000. This has been fueled, in part, by a 136 percent jump in customer conversion to the DVD format – a faster rate of adoption than any other home entertainment technology in history.

All told, rental revenues in 2000 totaled $8.3 billion, with VHS contributing $7.68 billion and DVD $0.57 billion (VSDA Report, Jan. 2001). VHQ has enjoyed a substantial increase in its own rental revenues, and we're poised to boost our market share even further with our growing selection of DVD and VHS titles.

Our present selection rivals that of our major competitors, with new titles arriving weekly. As our product line increases, we're tracking the same growth in our customer base, who have come to equate the VHQ brand with "everything entertainment"™.

Revenue-Sharing

Today, much of our sizable selection and copy-depth stems from revenue-sharing agreements formed directly with major U.S.-based film studios.

In the past, traditional video stores were required to purchase individual movies for anywhere between $60 and $80 per copy from video and home entertainment distributors. A large selection of movies meant an even larger overhead – hosting a limited selection of hit titles was the most viable means of staying profitable. Even so, many of the smaller, independent chains have closed their doors; the result of profits lost to high cassette costs, inferior selection and general customer dissatisfaction.

With VHQ's unmatched growth in fiscal years 1999 and 2000 and the Company's resulting expansion in store count, reputation and customer base, came the opportunity to enter into revenue-sharing agreements directly with several U.S.-based film studios. Under this model, our purchase costs are virtually eliminated in exchange for revenue-sharing participation with the studios. In this way, much of VHQ's inventory risks are mitigated by sharing such costs with the studios themselves.

Selection & Diversity

VHQ is dedicated to providing its customers with the widest possible array of entertainment choices. Our entry into revenue-sharing agreements has opened the doors to new opportunities for diversifying and increasing our selection of movie titles. In this, an immediate competitive advantage has been obtained over smaller video chains – we are now able to guarantee the availability of hit movies, maintain an increasingly large stock of titles at a minimal cost and thus solicit an even larger clientele of demanding consumers.

Strategic agreements of this nature position VHQ favorably for the adoption of new technology, such as Video-On-Demand and custom CD creation agreements with major record companies, and for the pursuit of further alliances with other retailers and suppliers to the entertainment and technology sectors. As an "everything entertainment" ™ retailer, we will continue to provide our customers with more choice, quality and value while reaping the financial rewards that these diversified revenue streams will create.

Movie Merchandising

The popularity of movies has had a positive effect on collateral products – namely that of movie merchandise and memorabilia.

Diversifying our product line to include these collateral items has benefited VHQ in numerous ways. Aside from the obvious increase in profits, the presence of movie merchandise in our stores reinforces the allure of the movies, publicizes key titles and effectively brings movie marketing into the home.

Hit movies create a strong fan base. By catering to these fans, VHQ is effectively generating higher-value customer traffic into our stores.

The Role of DVD

With each passing year, the rising popularity of the Digital Versatile Disc (DVD) has exceeded even the most optimistic of expectations.

Between January and December of 2000, DVD rentals went up from 4 percent to 12 percent of all rentals in the United States, with similar results in Canada.

Statistics regarding the sale of DVD software were by far the most encouraging – an unbelievable 269 percent increase in 2000 over 1999, with DVD year-end sales of $4.03 billion.

VHQ positions itself to capitalize on these increases and today carries amongst the best selection of DVDs in the marketplace. The inclusion of DVD-ROM drives in home PCs, and the emergence of converging platforms such as the Playstation 2 game console has further enhanced our business, permitting the up-sell of DVDs to gamers and computer users alike.

When the DVD format reaches maturity, the potential for revenue gains will be astronomical. Even now, in its infancy, the DVD player has penetrated the market faster than the VCR ever did. As DVD players drop in price, consumers everywhere are converting their living rooms into home theatres, and VHQ is uniquely positioned to cater to *all* of their entertainment needs.

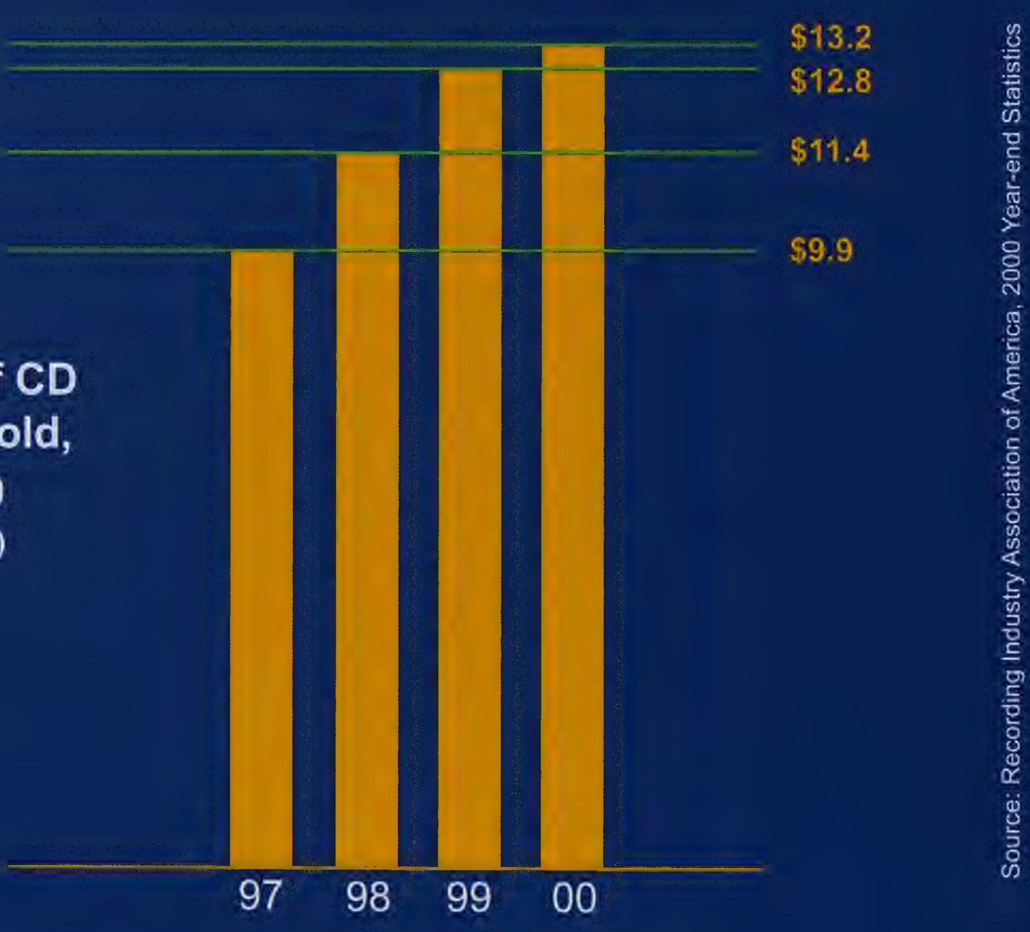
Fast Forward

Achieving integration between our physical stores and the Internet, our alliance with E-Trend Networks has not only permitted us to showcase and sell our line of entertainment software to a global market – it has allowed us explore new and exciting developments in content delivery and has opened the door to a world of infinite entertainment possibilities.

In the near future, Video-on-Demand (V-O-D) technology promises to revolutionize our industry with the capacity to beam entertainment directly into the home. Working closely with E-Trend Networks, we're turning this possibility into a reality, well before the requisite technology reaches its fruition. In doing so, we hope to introduce this exciting new method of content delivery before our competition does and claim a greater overall market share.

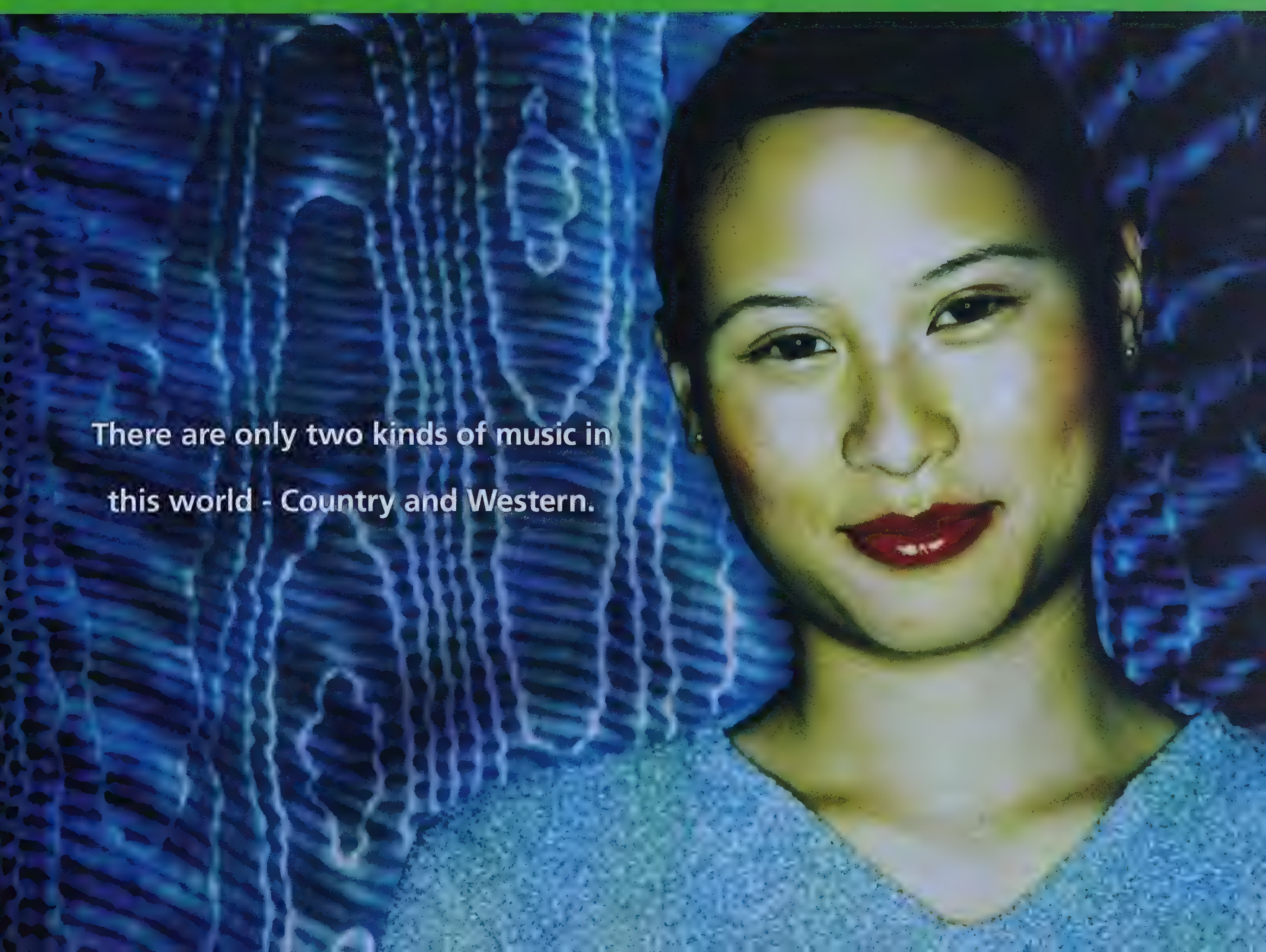
"Consumers have always maintained a love affair with movies, and their appetites consistently run the gamut of film genres, from Hollywood blockbusters all the way down to lesser-known "art films". Home viewing is still identified as the most convenient and reasonable means of watching movies – accounting for an ever-growing demand for films in both VHS and DVD formats."

The sale of music CDs is an important ingredient to the VHQ story, especially in rural areas where access to music is limited. In small urban and rural markets, VHQ is often the only music source in town.



Dollar Value of CD Music Titles Sold, 1997 - 2000 (in US$ Billions)

Music



There are only two kinds of music in this world - Country and Western.

The sale of music CDs is an important ingredient to the VHQ story, especially in rural areas where access to music is limited. In small urban and rural markets, VHQ is often the only music source in town.

$2.00 off Any Music CD

This coupon is valid at a VHQ location near you.

VHQ™

Not valid with any other offers. Expires September 1, 2002.

Music

Our customers' entertainment choices are as individual as they are. When a customer walks into a VHQ store, there is no physical indicator that can tell us which songs they like to hum in the shower, what music reminds them of their first kiss or what beat they can't resist dancing to. Happily, our customers themselves tell us about and request the music that moves them. The result: ever-growing music departments in VHQ stores across Western Canada. Sounds good to us.

At a time when the silver screen was black and white, and long before video games had even been considered possible, record companies were already enjoying mainstream success. Today, the music business is one of three great global entertainment industries, catering to the melodic wants of a diverse array of consumers.

As investors in human creativity, record companies have successfully championed their artists' creative integrity, discovered new talent, established new forms of music and pioneered extensive developments in digital audio technology and content delivery.

As investors in everything entertainment™, VHQ was quick to identify music's potential for attracting new customers and for more thoroughly catering to the wants and needs of our existing clientele.

We first introduced music departments into our chain over the course of fiscal 1999 after testing the concept in several of our Alberta-based stores. A veritable overnight success, we were quick to capitalize on the market potential for providing smaller urban and rural customers with the music selection they were previously hard-pressed to obtain.

Music has always existed at the crossroads of creativity and technology. CDs can now be played on DVD players and Playstation consoles, effectively increasing their demographic range. New formats are emerging, namely DVD-Audio and Super Audio CDs, fiercely vying for control of future markets. Record companies are developing new business models and protected audio formats for the Internet, in an effort to embrace web-based content delivery and reap the rewards previously "borrowed" by public file-sharing platforms.

THE FUTURE IS INDEED PROMISING.

Larger than Life

From the record companies that keep shelves stocked with the latest releases to the diehard fans that pay upwards of $100.00 for concert tickets, one thing is clear – music sells.

Despite a 1.2 percent drop in unit sales over the course of 2000, largely attributed to the progressive "phasing out" of cassette tapes, the global music market was still going strong at US $36.9 billion in sales, with sales of 3.5 billion units worldwide. Canada and the U.S. continue to dominate the market, with the distribution of 1.79 billion units for a grand total of over $14 billion in sales. This represents 38 percent of the total world music market, and is indicative of the western hemisphere's obsession with music stardom.

Music sales revolve around the interplay between content and image. In the 15 to 24 age group, responsible for a staggering 25.4 percent of total music purchases, the intensive promotion of a band's image is vital to building a lasting fan base. The second largest category, those 45 and older, are primarily interested in content and are therefore lesser targets for music marketing and merchandising.

In terms of genre, the 2000 double-digit performers were Rock, with 24.8 percent of purchases, Rap and Hip Hop, with 12.9 percent, Pop music, with 11 percent, and Country, with 10.7 percent of the market share. Here too, we see a difference in music preference by age, with younger listeners more interested in rap, hip hop, and pop music than their older counterparts.

Perhaps the most telling statistic regarding consumer trends in 2000 was *where* consumers were buying their music. While the percentage of traditional record store purchases dropped 2.1 percent to 42.4 percent of total purchases, the "other store" category – namely that of non-music-specific retail chains – rose 2.5 percent to claim 40.8 percent of music sales.

Put simply, stores that offer multiple types of entertainment media are enjoying success, while stores that specialize in only one form of entertainment are on the decline. As technology converges even further, this trend will only increase, with both short and long-term benefits to VHQ departments.

The CD

Despite a growing number of data and audio storage formats, the CD continues to be the most widely accepted form of currency in the digital age.

CDs are multipurpose. They can be played at home, in cars, on portables, on Playstation consoles and on DVD players. They can be accessed via computers, where exceptional data storage capacities have made the CD a market commodity.

Aside from its value as a multiuse disc format, the bulk of a CD's worth lies in its content. Every audio CD represents the culmination of extensive creative, recording, promotion and marketing costs. And yet, between 1983 and 1996, the average price of a CD was reduced by more than 40 percent– in direct opposition to a consumer price index that was rising by 60 percent over the same timeframe.

CDs are one of the few entertainment delivery formats to have ever declined in price, and yet the medium has experienced steady growth in unit sales and profits since its first release. Costs vary from country to country, with Canada's CD prices among the lowest in the world – a US $14 per CD in Canada costs $16 in the U.S., $21 in Germany, and $25 in Japan and the U.K. This is encouraging – under present distribution channels, VHQ is able to provide the highest value to its customers at the lowest possible cost.

DVD-Audio and the Super Audio CD

During fiscal 2000, a small blip appeared on the radar of the Recording Industry Association of America's Year-end statistics. DVD-Audio had sold 3.3 million units, at a dollar value of U.S. $80.3 million – a relatively insignificant figure, until one considers that this medium has grown 652 percent since its debut in 1998.

The sophisticated capabilities of the DVD format are opening new doors for music. The consumer now has access to a previously unheard level of sound quality, with multi-channel support to make full use of today's surround sound entertainment capabilities.

Musicians are now able to enhance their albums with added-value materials including song lyrics, music videos, graphics and interviews – all on the same disc and for the same price.

Not to be outdone, Sony and Philips have developed their own competing audio format, the Super Audio CD. Built on DVD's physical characteristics, the SACD mimics the features of DVD-Audio, while including an optional CD layer for playback on standard Compact Disc players – a reverse-compatibility that may prove vital to garnering mainstream consumer acceptance.

Will a victor emerge between DVD-Audio and the Super Audio CD, or will consumers adopt both formats? VHQ is tracking this new technology intently, prepared for the implementation of one (or both) of these new delivery methods when consumer demand increases.

Customization

The Internet is easily the most powerful influence over the music industry's immediate future. File-sharing programs like Napster, while illegally distributing copyrighted music over the Internet free of charge, nevertheless paved the way for serious consideration regarding the online delivery of music content.

Contrary to popular belief, file-sharing had a minimal effect on the full-length CD market. The CD singles market took the brunt of the beating, with a 38.8 percent decrease in sales over the 1999-2000 period. Many argue, however, that the market losses were merely a sign of obsolescence – that online access to music singles were, legal or not, the next logical step in the category's evolution.

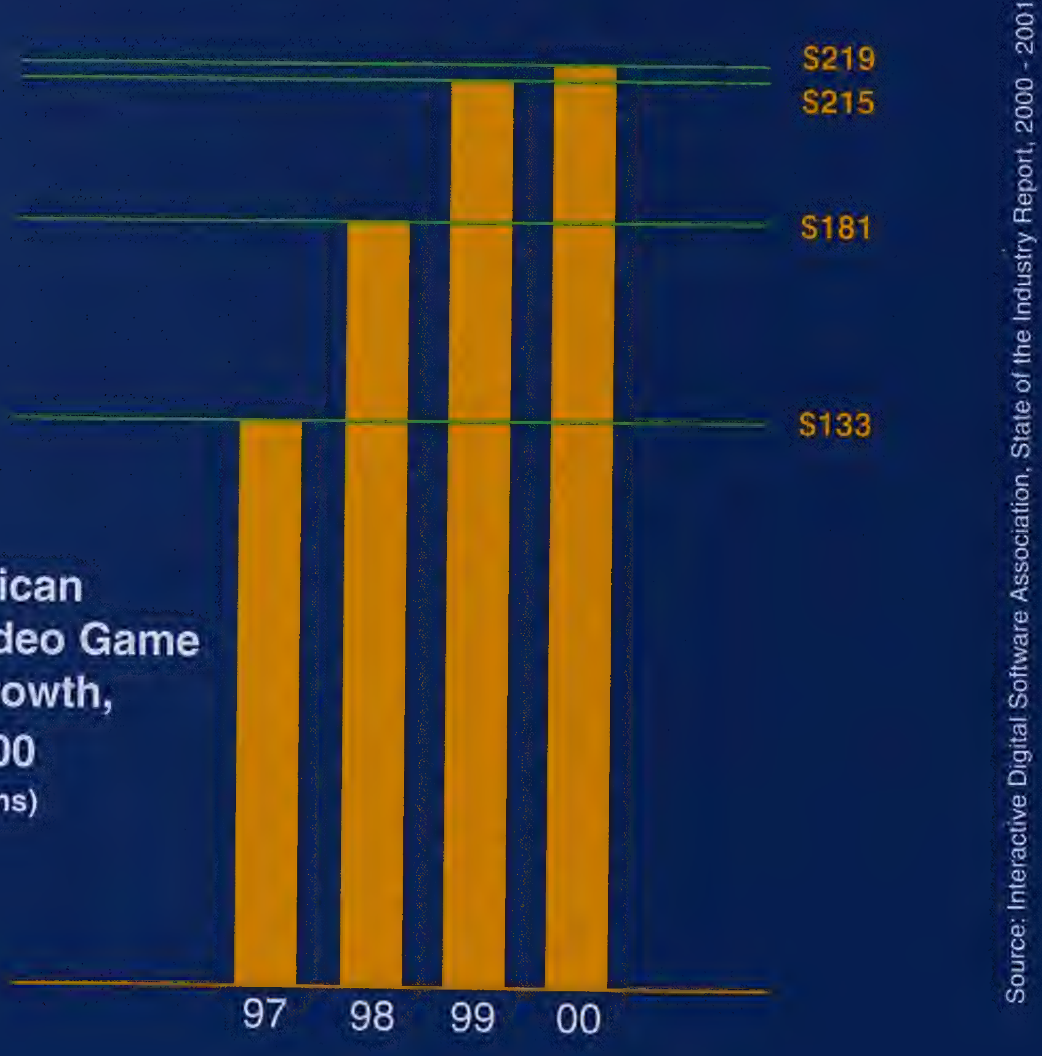
Record companies have recently caught on to this potentially lucrative market, preceded by VHQ's own initiatives in this matter. In last year's report, we spoke of a burgeoning opportunity for custom CD creation at VHQ stores, enabling our customers to create their own personal music compilations and CD labels.

As record companies develop systems for online licensing, VHQ will act quickly to offer custom CD creation to consumers – a testimony to our ongoing commitment to provide our customers with as many entertainment choices as possible.

"As investors in human creativity, record companies have successfully championed their artists' creative integrity, discovered new talent, established new forms of music and pioneered extensive developments in digital audio technology and content delivery.

As investors in everything entertainment™, VHQ was quick to identify music's potential for attracting new customers and for more thoroughly catering to the wants and needs of our existing clientele. "

VHQ understands the importance of gaming. Today, seven out of ten young adult inhabited households now own a computer or game console, compared to one out of two in 1995.



North American Computer and Video Game Unit Sales Growth, 1996 - 2000 (in US$ Millions)

Games

I'm not sure I could survive without Tony Hawk's Pro Skater 2. I haven't managed to grind the propeller on stage one yet, but I'll keep trying. If there's anything business school taught me, it's to never give up on my goals.

VHQ understands the importance of gaming. Today, seven out of ten young adult inhabited households now own a computer or game console, compared to one out of two in 1995.

This coupon is valid at a VHQ location near you.

VHQ™

Not valid with any other offers. Expires September 1, 2002.

Games

Gamers are great adventurers. Not content to sit back and be entertained from afar, they put themselves into the action daily. From their very own homes, these are the people who seek lost treasure, are willing to take on death-defying athletic challenges and are unafraid to tackle the responsibility of battling creatures from distant planets. At VHQ, we feel we have a great responsibility also – to provide the games that feed their passion, imagination and relentless desire to win.

In 1975, a simple agreement allowed Sears department stores exclusive rights to the sale of Atari's new electronic game, Pong. Atari would record overall sales of close to $40 million – an unheard-of sum that signaled the birth of the computer and video game industry.

Ten years later, with the release of the 8-bit Nintendo Entertainment System (NES), home video games had reached a respectable level of mainstream popularity. Competition was fierce, as dueling companies were developing sophisticated platforms on which to host an ever-expanding roster of interactive entertainment.

The latest innovation, Sony's PlayStation 2, consists of a 300-MHz processor that allows users to not only play games at a previously unseen level of quality, but to watch DVDs, listen to CDs, and access the Internet on their systems as well. In an effort to match this bold new precedent in convergence, Microsoft is soon to release its Intel-based Xbox, and Nintendo is developing its much-anticipated GameCube.

Twenty-five years ago, the idea that video games would evolve into a multi-billion dollar industry would have been rejected immediately. Yet today, that's precisely where the electronic game industry stands.

Our Healthy Obsession

The introduction of video game sections to VHQ stores in fiscal 1999 was a major step towards providing everything entertainment™ for our customers.

The rental and sale of games, consoles and gaming accessories has boosted VHQ sales, with converging platforms inspiring gamers to make cross-purchases of CDs and DVDs for their systems.

The popularity of our video game departments continues to rise, as players young and old lose themselves in the challenge and excitement of next generation interactivity. Titles like "Tony Hawk's Pro Skater 2" may immerse the average gamer for upwards of two months, as interactivity maintains a longer-lasting appeal, and thus solicits a diehard loyalty that is rarely found in other areas of passive entertainment. As new platforms are released, games are becoming progressively more sophisticated – and so too are the people who play them.

Dispelling the Myths

Gone are the days when game enthusiasts were characterized as lonely basement-dwellers – younger males, ill-equipped for social interaction. Today's avid gamers defy any attempts at classification, unified solely through their pursuit of exciting new challenges.

By recent estimates, about 145 million people play computer and video games on a regular basis in the United States alone. These numbers are indicative of a mainstream obsession with electronic gaming – far from the "fringe pursuit" of the 1980s.

Contradicting the notion that video games are merely for adolescents and teens, the average PC/console gamer is 28 years old. Thirty-two percent of Americans who play video games are reportedly 35 or older, and a remarkable 13 percent are over the age of 50 – a telling sign of the mass appeal that interactive entertainment has generated in our culture. Video games truly have become a form of "everybody entertainment".

In a recent study conducted by Peter D. Hart Research Associates, it was found that 43 percent of PC and console gamers were women, of which the average age was 29. This further debunks notions that video games are primarily a male domain, and has encouraged the interactive entertainment sector to design games that appeal to both men and women alike.

Despite the diverse array of gamers in the market, developers and retail chains continue to train their marketing sights on a smaller, younger core market of loyal enthusiasts, responsible for an estimated 60 percent of industry sales. Possessing more disposable income than ever before, frequent users in this category own an average of 13 games and are primarily responsible for setting the trends that turn popular titles into all-time best sellers.

The Market

The video game industry has experienced consistent, sustainable growth since its birth twenty-five years ago. From 1997 to the present, sales of interactive games have consistently exceeded the motion picture box office average of 7.5 percent, with a whopping 15 percent in annual growth.

With many customers looking to test-drive a game before committing themselves to a purchase, the hype surrounding new game releases has translated into serious profits for home entertainment rental as well. In 2000, revenues from game rentals totaled a record $919 million – up from the previous record of $880 million set in 1999.

In the communities where our stores are located, gamers recognize VHQ as a trusted source for the widest selection available for rental. Our loyal gaming customers allow us to derive high profit from each individual title, as unlike film renters, gamers are likely to rent the same title repeatedly for weeks and months on end. Once in-store, gamers are buying CDs and DVDs to complement the diverse capabilities of their next generation platforms – a trend that will only increase as the new generation of consoles are set loose on the market.

Room to Grow

The future of game development is without boundaries. Advances in microprocessors and graphics technology allow for game designers to create awe-inspiring entertainment that satisfies the tastes of even the most finicky of gamers, while actively encouraging a startling number of new recruits to join in the experience.

This is by no means a new phenomenon - traditionally, the market for game consoles has increased by more than 50 percent with each technological progression. But with the release of the Playstation 2 game console, the wall between interactive games and other forms of home entertainment has effectively been reduced to rubble, paving the way for a bold new era of unsurpassed growth.

Looking ahead, we anticipate a further increase in rentals, sales, up-sell and customer loyalty, with gamers flocking to VHQ for all their DVD, CD audio and game accessory purchases.

Now, more than ever, games are big business. And as a growing number of converged entertainment platforms make their way into the market, VHQ will continue to maintain a strong presence via our unparalleled selection of interactive entertainment, highly competitive prices and readiness to implement new product lines.

In-store or online – we're making sure that our customers find the games they crave, and we will continue to do so as new hardware and software is made available to the public.

"With many customers looking to test-drive a game before committing themselves to a purchase, the hype surrounding new game releases has translated into serious profits for home entertainment rentals. In 2000, revenues from game rentals totaled a record $919 million – up from the previous record of $880 million set in 1999.

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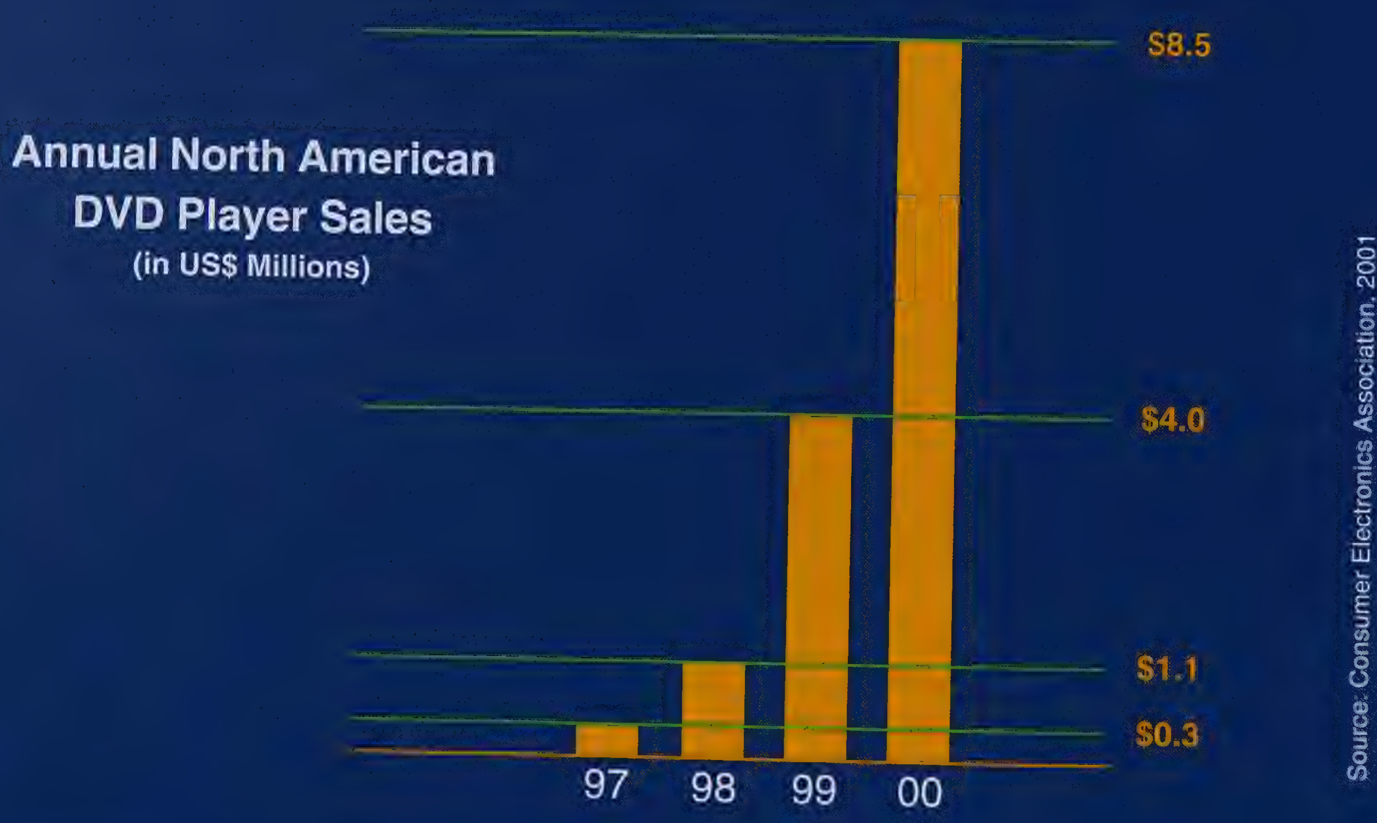
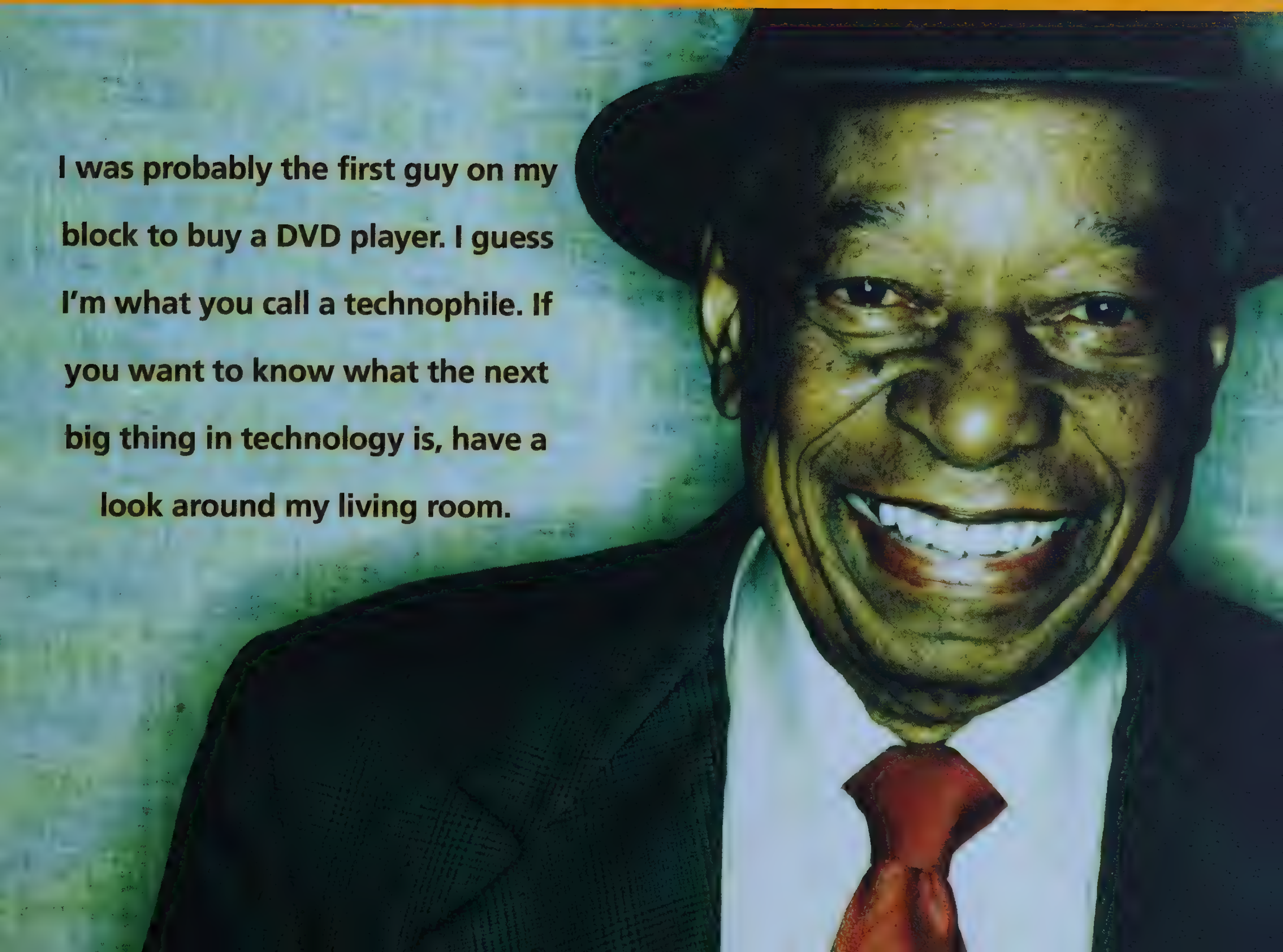
Rather than being intimidated by emerging technologies, VHQ is leading their application to home entertainment. VHQ is in the forefront of retailing these new formats in its stores and, in the near future, direct to homes through broadband distribution.



Evolution



I was probably the first guy on my block to buy a DVD player. I guess I'm what you call a technophile. If you want to know what the next big thing in technology is, have a look around my living room.

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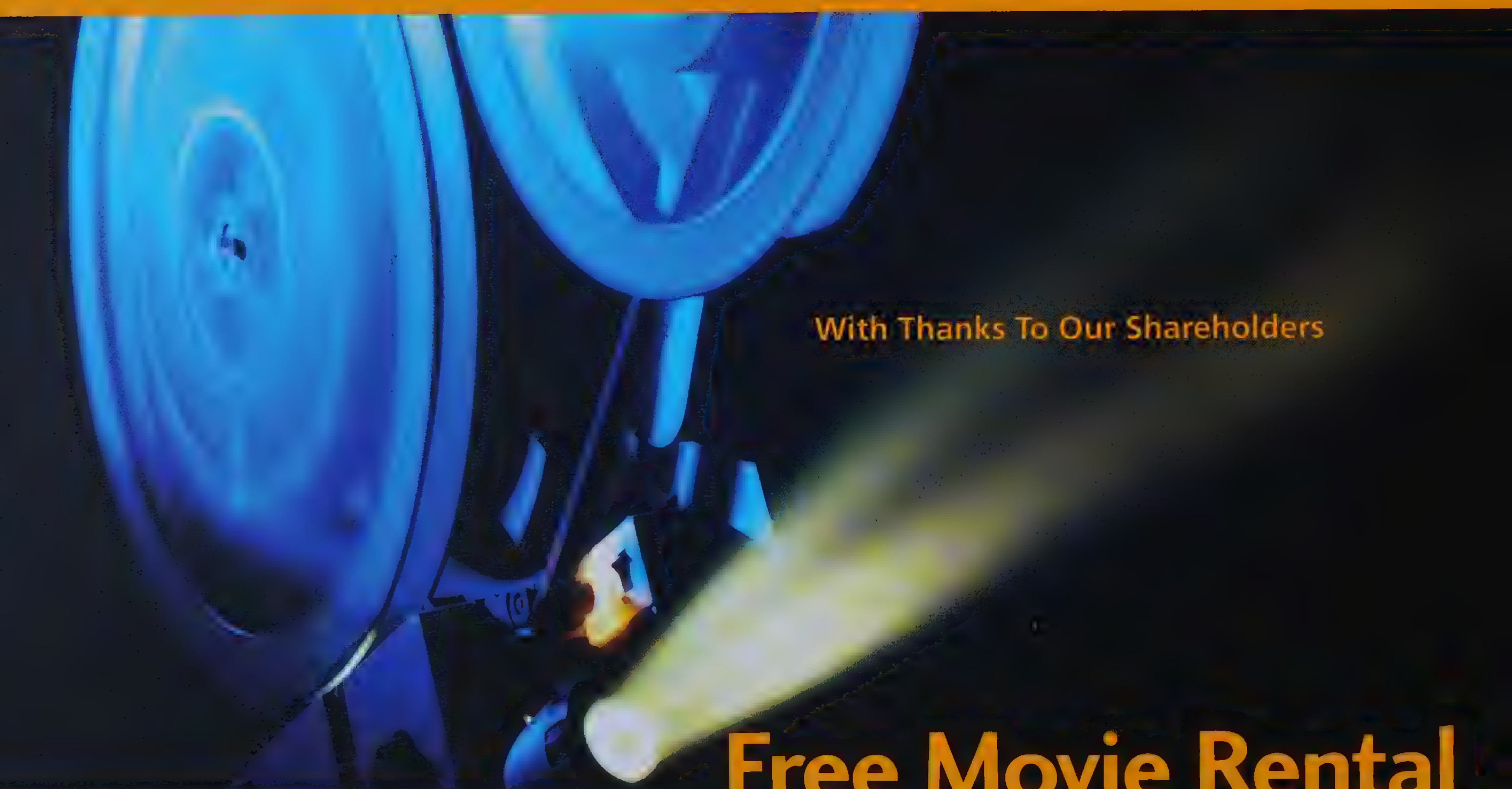

Free Movie Rental

This coupon is valid at a VHQ location near you.

VHQ™

Evolution

Technology and entertainment are no longer two separate entities. There has been a revolution in entertainment technology underfoot for several years, and today, the two have become inseparable. As a result, shifts in entertainment technology force us to constantly rethink the way we do business. How do we prepare? By looking ahead. We see what's coming, understand how customers think about and use technology, prepare internally and then offer the right technology at the right time. It's that simple.

One Small Step - In March of 1997, DVD players made their debut in the United States. At that time, very few people in the industry thought this pricey (the average player was over $1000) new technology would ever gain the mainstream appeal that it has. DVD growth has, in fact, been startling.

DVD has unquestionably become the most powerful new medium to ever be introduced into the home entertainment market, with penetration in 2000 estimated at 13 percent of U.S. households, and a 2001 forecast that suggests DVD penetration into households will double yet again.

People are embracing every new development. Never has technology been met with such rapid adoption, and yet we can accept this as more of a trend than a mere anomaly. Consumers are investing an increasing amount of their hard-earned income into home entertainment.

The line between technology and entertainment, if ever there was one, is gone for good. And to grow in this new environment, VHQ recognizes that it must support, embrace and facilitate change – one giant leap at a time.

The Online Environment

In 2000 alone, 2.6 trillion emails were sent worldwide – this number is expected to triple by 2005, proving the Internet's effectiveness as a communications conduit.

From home computers to cyber cafes – the Internet is everywhere, and it is drawing an impressive audience. In 2000, there were over 167 million Internet users in North America, representing every age, race and tax bracket.

With each passing year, millions of new users go online to join in the experience, prompting web access providers to update their networks, expand their bandwidth and research newer, faster means for connecting the populace.

The development of wireless technology promises to do just that, by eliminating the need for costly fiber optics and lengthy, inconvenient installs. It is estimated that by 2005, 730 million Internet users worldwide will be accessing the web without any physical connection to their servers, heralding in a new age of technological development. And as the technology sector experiences rapid growth and change, rapid consumer adoption of these advancements has increased like never before.

Turning Clicks into Dollars

Last year, global e-commerce totaled $657 billion dollars U.S. Projected totals worldwide for 2001 are $1.233 trillion dollars – almost twice that of the year before. It is with this in mind that VHQ (through www.Vhq.ca) and our subsidiary E-Trend Networks Inc. (through www.EntertainMe.com) gear up for another busy year of web-based transactions, eager to grab as much of the market share as possible.

Of all the users online in 2000, fully 70 percent were looking for entertainment-related content, fueling a pre-Christmas craze that lead to almost $1 billion dollars in online sales of movies, music, and games in the months of November and December.

Rather than eclipse physical stores, the Internet is best viewed as an additional convenience channel – an augmentation of the retail shopping experience. Web-only services, and physical stores with no Internet presence, are the only consumer categories at risk from changing economic climates – it is through an integration of bricks and clicks that true market potential is realized.

Consumers have expressed wariness when dealing with web-exclusive retailers. Among the many concerns, issues involving lost orders, returns and exchanges rank high on the list, prompting many would-be customers to avoid taking chances.

Rather than establish an autonomous Internet retail service, EntertainMe.com and VHQ.ca were envisioned to provide seamless integration between the Internet and our physical stores.

Collectively, VHQ.ca and EntertainMe.com act as a gateway to over 100,000 movies, a million music titles, countless games and entertainment-related merchandise. E-Trend Networks has pioneered a truly unique way to shop online, with real-time online customer service representatives and recommendation engines that help our customers find exactly what they're looking for. Best of all, any item bought online may be returned or exchanged at our physical store locations – an added peace of mind when shopping the intangible Internet.

Our Future is Now

Progress, particularly in the entertainment sector, can be widely attributed to converging technologies – audio, video and online hybrids that create new possibilities for the consumer while encouraging existing formats to upgrade.

The popularity of the DVD format is setting a new standard for home entertainment and has facilitated a crossover into the music category through the release of high-fidelity DVD-Audio and Super Audio CD formats.

The Playstation 2 game console is the first of a series of next generation hybrids that will play DVDs, CDs and access the Internet via small, all-in-one units that promise to dramatically increase sales in every home entertainment category.

Crossing Paths

The popularity of all-in-one entertainment stores is on the rise. As content converges, consumer interest diversifies – and VHQ positions itself to benefit from this dynamic interplay. Movies, music, games and beyond, our goal is to remain on the cutting edge of entertainment, and miles ahead of our competition.

By building lasting relationships with movie studios and record companies, VHQ strives to provide its customers with the largest possible selection of entertainment choices at the lowest possible price.

Through both traditional and online commerce, the Company is focused on attracting new customers and increasing per-customer spending via new corporate alliances and aggressive consumer incentive policies.

Our obsession with connectivity has us looking to expand our e-commerce base, as well as exploring opportunities to implement wireless and satellite connections in mid-sized and rural locales, where content has traditionally come at a high premium.

Finally, as entertainment platforms continue to converge on one another, VHQ expects massive profit increases in all of its departments, with one-stop home entertainment destinations replacing obsolete, format-specific chains.

The future of entertainment technology is all about choice – and at VHQ, we choose to lead the way.

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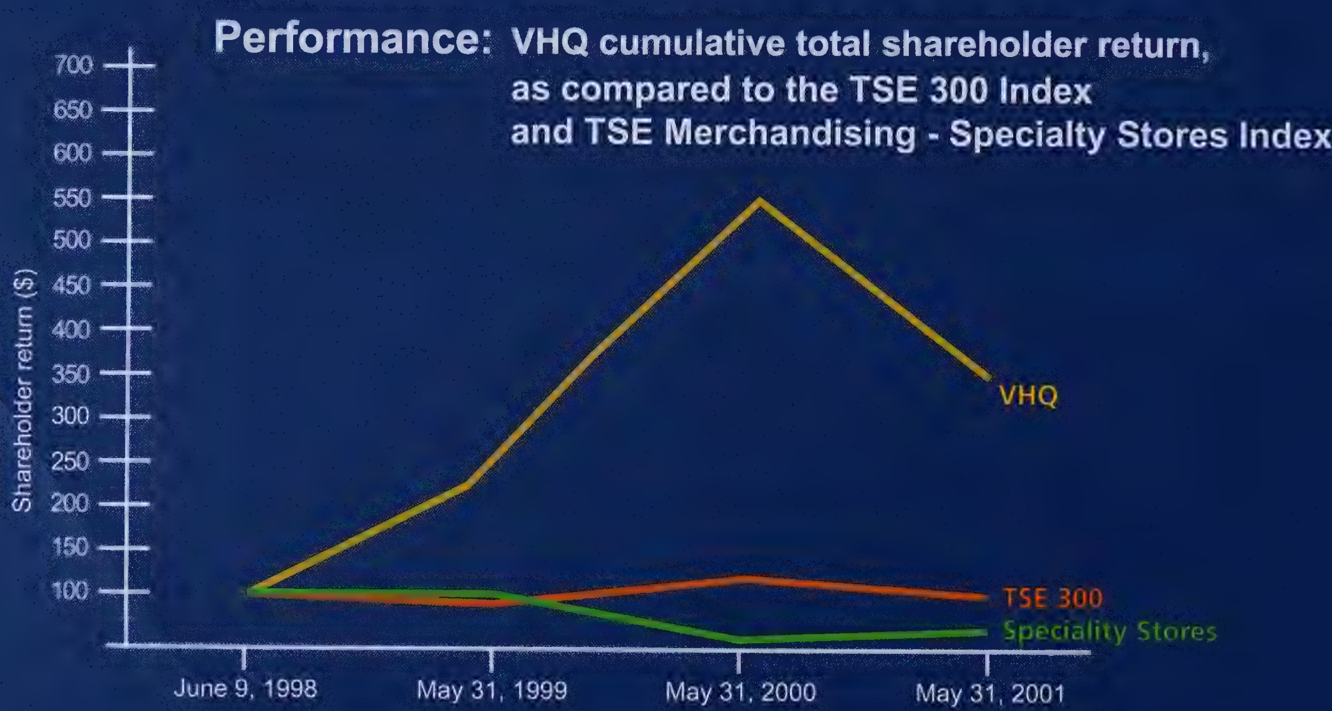
The spirit of VHQ is one of unfailing dedication - a commitment to constant growth and refinement, an emphasis on the importance of change, and an endless search for imaginative ways to serve our customers and create value for our shareholders.



Index	June 9, 1998	May 31, 1999	May 31, 2000	May 31, 2001
VHQ Entertainment Inc.	$ 100.00	$ 233.87	$ 677.42	$ 354.84
TSE 300 Index	$ 100.00	$ 91.79	$ 126.13	$ 112.67
TSE Merchandising — Specialty Stores Index	$ 100.00	$ 94.29	$ 51.74	$ 63.24

MD&A

Trevor M. Hillman

Director, President and Chief Executive Officer

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Gregg C. Johnson
Director and Executive Vice President

MD&A

Derrek R. Wong
Chief Financial Officer

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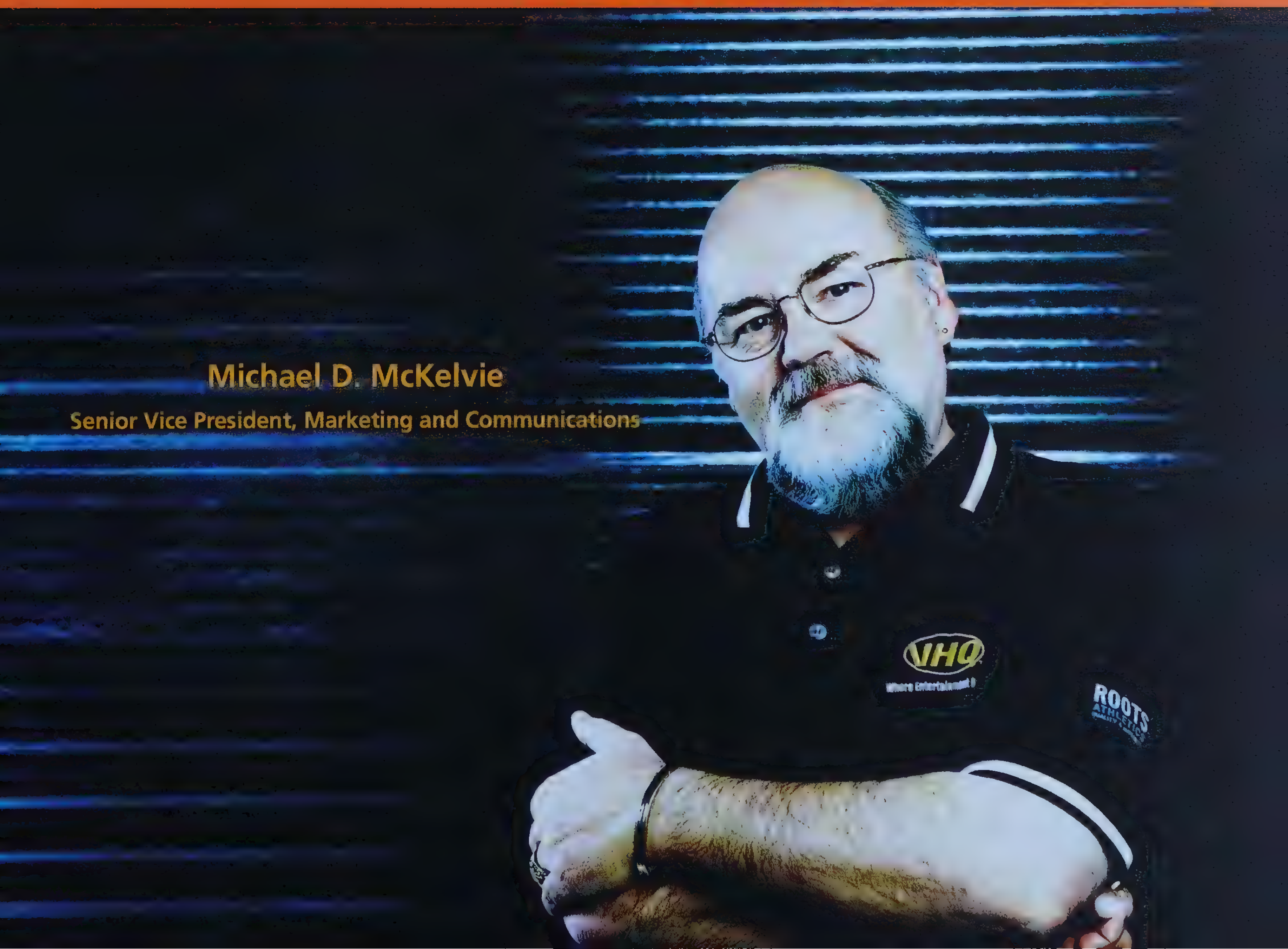
Timothy J. Sebastian
Secretary and General Counsel

MD&A



Michael D. McKelvie
Senior Vice President, Marketing and Communications

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Dan W. Sims
Controller

MD&A

As committed investors in and managers of this business, our objective is to focus on finding what is necessary for our investment and our company to thrive: the ability to stay not merely one, but ten steps ahead of our customers' needs. There is a sense of anticipation in everything we do, from finding the right location for our newest retail outlet, to assessing the long-term value of our next acquisition. We are committed to making these decisions with intelligence, confidence and consideration for the resulting impact on our business, and on shareholder value.

Management's Discussion and Analysis of Financial Condition and Results of Operations

This Management's Discussion and Analysis (MD&A) focuses on key statistics from the consolidated financial statements of the Corporation for the fiscal year ended May 31, 2001 and pertains to known risks and uncertainties relating to our business. This MD&A should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. This MD&A of the financial condition and results of operations for the year ended May 31, 2001 should be read in conjunction with the consolidated financial statements and related notes.

Business of the Corporation

VHQ's mandate is to build and operate a chain of video and home entertainment stores Canada-wide and internationally. As the primary focus of its retailing strategy, the Corporation targets neighbourhood markets in large urban centres, smaller urban centres, and rural communities with trading populations of about 10,000 people. These smaller markets typically have lower operating costs, less competition and potential for greater market share associated with smaller markets while still allowing for similar rental rates as seen in larger urban centres.

Over the last two years, the Corporation has also focused on two other primary objectives. The first was to diversify revenue streams and decrease the Corporation's reliance upon revenues generated from video rental. The second was to mitigate risks associated with the evolution of the Internet as a means of the sale and distribution of competitive goods and content offered in the Corporation's retail stores.

As part of its strategy to diversify revenue streams, the Corporation undertook a rebranding of its business, a process that will be largely completed by December 2001. In December 2000, the Corporation changed its corporate name and brand from Video Headquarters Inc. to VHQ Entertainment Inc. Under the new name and brand the Corporation promotes itself as not only a video rental retail business but as a home entertainment business offering a full line of entertainment products and services, including, the sale of CD music, the rental and sale of film entertainment products both in the VHS and DVD formats, the rental and sale of video games and related accessories, the sale of entertainment periodicals, studio related merchandise and a broad range of confectionery items. Management believes a full-line home entertainment store is more likely to attract and retain customers, as well as generate additional revenue opportunities from cross marketing the varied in-store product mix.

In order to mitigate the risks associated with the evolution of the Internet as a means of competitive distribution, the Corporation participated in the development of E-Trend Networks, Inc. ("E-Trend"), a Delaware public company trading on the Nasdaq Bulletin Board under the trading symbol "ETDN". E-Trend is engaged in the on-line sale of movies, games and music and is conducting research and forging alliances to create strategies to develop a commercially viable model to distribute filmed entertainment over the Internet. The Corporation holds a 40.1% equity interest in E-Trend.

Throughout fiscal 2001, the Corporation focused on expansion through internal growth and acquisitions. During this period, the Corporation added twelve stores to its retail network. Of this number, seven stores represented new build properties in the following communities: Brooks, AB; Lake Chaparral - Calgary, AB; Drumheller, AB; Lethbridge (West), AB; Panorama Hills - Calgary, AB; Coral Springs – Calgary, AB and Ponoka, AB. Five stores represented acquisitions in the following communities: LaRonge, Sask; Stony Plain, AB; Spruce Grove, AB; Dover – Calgary, AB and 115th Street – Saskatoon, Sask. The Corporation intends to continue its expansion plans during fiscal 2002 and anticipates that these efforts will include the further expansion of the Corporation throughout rural Alberta, and into other markets, including British Columbia, Saskatchewan, Manitoba and the Northwest Territories. The Corporation is also currently identifying opportunities, and the associated risks of expansion, into Eastern Canada, including Quebec.

The Corporation made substantial efforts in completing the initiatives highlighted in last year's report to shareholders. In addition to re-branding most of the retail network to VHQ Entertainment, the Corporation has also been successful in rolling out the sale of music and other product mix items throughout the chain. Fiscal 2001 also heralded a number of significant steps as the Corporation was successful in its efforts to list its common shares for trading on the Toronto Stock Exchange and secure several direct purchase and revenue sharing agreements with the major US based film studios.

RESULTS OF OPERATIONS

Revenues

Total revenue increased 65.5% to $21.3 million for fiscal 2001 from $12.9 million for fiscal 2000. The increase was due to a number of factors, the most significant of which include: (i) an increase in same-store revenues of 17%; and (ii) a 36% increase in the number of stores operating during fiscal 2001 versus fiscal 2000.

The increase in same-store revenues was primarily the result of: (i) increased product availability for customers as a result of direct revenue sharing and copy depth programs for filmed entertainment products; (ii) a strong slate of new title releases versus the prior

year; (iii) the continued consumer acceptance and growth of the DVD platform; (iv) the successful chain-wide re-branding campaign and internal marketing program designed to generate more consumer excitement and purchase of items, including music and sell-through filmed entertainment; (v) the addition of CD music sales into a greater number of stores; and (vi) increases in ancillary sales, including predominantly confectionery items.

It has been the Corporation's experience that new-built stores typically reach mature revenue streams in 12 to 18 months from opening. Generally speaking, revenue streams mature earlier in the Corporation's rural markets and later in urban markets where the Corporation's stores face greater competition. As such, for so long as the Corporation continues its aggressive new-build strategy, Management anticipates strong revenue and same-store sales growth results from operations.

The relative mix of revenues between rental and product sales revenues for fiscal 2001 were 78% and 22%, respectively. This ratio remained consistent with fiscal 2000 revenues that were 79% and 21%, respectively. Many of the gains experienced in the addition of sales related to music were matched by similar gains in rental revenues resulting from greater copy depth and the addition and growth of the DVD rental market. Management expects such rental and product revenue ratios to remain stable over fiscal 2002 with some slight gains likely to be experienced in the product sales category as result of anticipated DVD sales during the Christmas 2001 season.

Rental revenues include rentals of VHS videocassettes, DVDs, video games, and sales of previously viewed VHS, DVD and video games. The Corporation's strategic decision to increase its inventory of DVDs resulted in DVD rental revenues increasing to 15% of rental revenues for fiscal 2001 compared to less than 5% of rental revenues for fiscal 2000.

Revenues from product sales include sales of all items, excluding previously viewed VHS, DVD and video games. This category includes the sale of confectionery, CD and cassette based music, sell-through filmed entertainment on VHS and DVD, gaming accessories, studio merchandise, posters and ancillary goods.

COST OF SALES

Rental Revenues

Rental revenue costs for fiscal 2001 were 26.4% of rental revenues, a slight increase from 20.3% in fiscal 2000 due primarily to the significant concentration of product purchases in the fourth quarter of calendar 2000. The cost of rental revenues comprises the amortization of rental inventory, including videocassettes, DVDs, video games and equipment for rent, as well as revenue sharing expenses incurred by the Corporation. The amortization expense associated with rental products amounted to $2.6 million, representing 59.5% of the cost of rental revenues for fiscal 2001. Comparatively, such amortization expenses for fiscal 2000 were $1.5 million, representing 69.9% of the cost of rental revenues. The decrease in amortization expense as a percentage of revenue is attributable to the Corporation shifting purchases of new rental product towards revenue sharing programs in which the initial capital outlay is lower.

The Corporation commenced revenue sharing programs in November 2000 and the initial financial effects of these and subsequent programs are reflected in this period. Management anticipates that more significant positive results will be generated in the future as the Corporation derives greater revenue from the rental of product provided under such revenue sharing agreements.

Product Sales

Cost of product sales includes the costs of new VHS videocassettes and DVDs for sell-through, confectionery items, CD and cassette based music, video gaming accessories for sale and other goods inventoried for sale. The cost of these products as a percentage of the revenue generated was 77.2% for fiscal 2001, a slight decrease from the prior fiscal year results that posted 81.6%. The decrease is primarily attributable to greater supplier discounts particularly with respect to purchases of CD based music in the third and fourth quarters of fiscal 2001.

Gross Margins

Total gross margin posted by the Corporation for fiscal 2001 amounted to $13.3 million, an increase of 54.2% over the $8.6 million posted for fiscal 2000. The increase in the gross margin resulted directly from a significant increase in revenues during the period, together with a successful program to control expansion costs. Overall gross margins declined to 62.3% for fiscal 2001 from 66.9% for fiscal 2000, the decline resulting from the Corporation's participation in revenue sharing and copy depth programs for filmed entertainment that, on average, have lower gross margins than do traditional buying arrangements. Additionally, increasing product sales, and in particular, CD music sales have negatively affected overall margins as product sales typically generate lower margins than do rental sales. Management anticipates that gross margins should remain relatively stable in the ensuing years as gains made from higher margin DVD rentals are offset by increased low-margin product sales.

Operating Costs and Expenses

Store operating expenses that include store-level expenses such as lease payments, in-store labour costs, and repairs and maintenance, increased slightly to 43.9% of total revenue for fiscal 2001, up from 42.9% for fiscal 2000. The increase in store operating expenses is primarily due to an increase in the number of stores operating in larger urban centers that, generally, require higher per square foot lease payments, store updating/rebranding costs and higher wages paid to store level staff.

General and Administrative

General and administrative ("G&A") expenses increased to $2.3 million for fiscal 2001 from $2 million in the prior fiscal year. The increase results from higher administration salaries required in connection with the 36% growth in the number of stores, as well

as legal and professional fees associated with the listing of the Corporation's common shares on the Toronto Stock Exchange, and audit fees incurred in connection with back audits of subsidiaries as required by Regulation S-X of the United States Securities and Exchange Commission.

Although general and administrative expenses increased over those recorded in the prior year, they declined favorably to 10.9% of revenues for fiscal 2001 as compared to 15.2% for fiscal 2000. The Corporation is beginning to realize the benefits of economies of scale as G&A expenses are amortized over a greater number of operating stores. Management expects such favourable declines to continue as the Corporation currently retains a full compliment of management necessary to operate a substantially greater number of stores. Overall G&A will increase, however, as additional regional managers are added to the staff compliment, but the trend towards a reduction of G&A expenses as a percentage of revenue is expected to continue.

Amortization of Intangibles

Amortization of intangibles decreased slightly to 1.7% in fiscal 2001 versus 1.9% in fiscal 2000. This decrease is primarily due to the increase in same-store revenue in fiscal 2001. The Corporation continued to book additional goodwill in connection with its acquisitions made during the year. Management believes such goodwill additions are likely to continue for the foreseeable future as the Corporation continues its store acquisition program. Absent a substantial acquisition being completed, management expects the favorable trend towards a decrease in amortization of intangibles, as a percentage of revenue, will continue.

Operating Income

As a result of the above factors, excluding the impact of the amortization policy change and the write down of investment, operating income increased by 39.2% to $1.24 million in fiscal 2001, up from $891,794 in fiscal 2000. Increases in operating income resulted from increased same-store sales and revenue gains. Management expects to keep expenses in line with revenues and, as such, the current trend toward improvements in operating income to continue. Given the nature of the Corporation's expansion, management anticipates financial results will continue to benefit from direct revenue sharing agreements, economies of scale, maturing store revenues and additional revenues generated from the added retail product mix in each respective market.

Video Limited Partnership Disbursements

In December of 1999, the Corporation completed an agreement whereby it sold certain capital assets for net proceeds of $4.0 million resulting in a gain of $1.3 million. The funds were raised through the disposition of rental movies and games in Integrated Retail Corp., a subsidiary of the Corporation, to Video Limited Partnership. The partnership in turn engaged VHQ Entertainment Inc. (formerly "Video Headquarters Inc.") to manage the distribution and rental of such rental inventory comprised of movies and games, and the parties agreed to split the revenues generated from these capital assets. The Corporation has an option exercisable on demand at any time after June 30, 2001 to reacquire these capital assets.

Payments to Video Limited Partnership amounted to $1.5 million in fiscal 2001 as compared to $732,990 during fiscal 2000. The increase is attributable to the fact that payments made during fiscal 2000 commenced in December 1999 and, therefore, were not made for a full one-year period. Payments to Video Limited Partnership amount to approximately $125,000 per month. Of such amount, a graduated portion is applied to pay down the principal portion of the initial $4.0 million purchase of capital assets. As the Corporation now has the right to exercise its option to reacquire the capital assets, it is examining several options, including outright repurchase or conversion of the fair market value into equity of the Corporation.

Net Interest Expense

Net interest expense decreased to 0.6% in fiscal 2001 versus 1.2% in fiscal 2000. This decrease was primarily due to reductions in average debt outstanding during fiscal 2001.

Income (Loss) before Income Taxes and Extraordinary items

In fiscal 2001, the Corporation posted a loss before income taxes and extraordinary items of $387,803 compared to an income of $7,307 reported in fiscal 2000. The relative results are comparable given the fact that the Corporation did not remit payments to Video Limited Partnership for the whole of fiscal 2000. Management expects this to improve as expanded operations provide added revenue and cash flow from operations without the one-time non-recurring charges that have been incurred in connection with exchange listings and US registrations. Management recognizes the need to deal with disbursements made to the Video Limited Partnership, and if successful in paying such remaining balances off, or converting such balances to equity, the net effect will likely be both accretive to earnings and non-dilutive from an income perspective.

Recovery of Income Taxes

The income tax recovery in the amount of $1.72 million is largely attributed to the change in the estimate of the useful life of rental product and to the write-down of the investment in E-Trend Networks, Inc. As a result of these two changes, the differences between the tax cost and the accounting cost of certain assets and liabilities on the balance sheet has been reduced, resulting in a future tax recovery.

Investment Write Down

As at May 31, 2001 the Corporation held a 40.1% equity interest in E-Trend Networks, Inc. ("E-Trend"), a public Delaware corporation trading on the NASDAQ Bulletin Board under the trading symbol ("ETDN"). E-Trend is engaged primarily in the on-line sale and distribution of movies on VHS and DVD, music on CD and video games on various platforms. E-Trend is also engaged in the research and development of technologies and strategies to mitigate the evolution of the Internet as a means of competitive distribution to the Corporation. Due to current market conditions, and in particular to conditions respecting high-tech and "dot-com" companies in

general, management has decided to take a one-time, non-cash charge and effect a write down in the value of its ownership in E-Trend.

Management is advised that E-Trend continues to generate a loss from operations despite an overall increase in gross margins associated with product sales. Management has further been advised that E-Trend has taken steps to reduce its operating costs in light of current market conditions, and is awaiting the receipt of additional working capital to be used primarily for marketing purposes. Although E-Trend currently enjoys a positive gross margin on product sales, there is not a sufficient volume of sales to generate positive earnings. Management has been advised that E-Trend, as an event subsequent, filed a US Registration Statement on Form SB-2 in connection with its previously announced investment agreement for the placement of up to US$10 million of E-Trend securities. Management believes that, if E-Trend is successful in completing such equity placements, that it may have sufficient working capital to drive marketing programs capable of generating positive earnings. There can be no assurance that E-Trend will be successful in clearing registration with the United States Securities and Exchange Commission, or that if cleared, that it will be successful in completing a financing, or completing a financing on terms satisfactory to E-Trend. Furthermore, there can be no assurance that if successful in completing such equity placements, that E-Trend will have sufficient funds, or otherwise utilize such funds, to generate positive earnings.

Write-down of Capital Assets

Effective May 31, 2001, the Corporation changed its estimation of the useful life and salvage value of its rental product. As a result of this change, the Corporation has revised its estimates of the useful life of rental product to a twelve-month amortization period from twenty-four months and has reduced its estimate of the salvage value per item. This change has been applied prospectively as a change in accounting policy and resulted in a one-time write-down of capital assets in the amount of $2.26 million.

Net Loss

The Corporation recorded a net loss of $2.8 million for fiscal 2001 for the reasons stated above, as compared to a net profit of $2.1 million for fiscal 2000. Management does not anticipate any further write-downs for the foreseeable future.

Liquidity and Capital Resources

The Corporation generates cash from operations in connection with the rental and sale of entertainment software, including VHS, DVD, CD music and video games. Cash flow is strong as the retail business is typically a "cash" business whereby the Corporation does not typically carry receivables from customers. Historically, the Corporation's primary capital needs have been for opening and acquiring new stores and for the purchase of rental and sell-through inventory. Other capital needs include the refurbishment, remodeling and relocation of existing stores. The Corporation has funded these capital needs, as well as new store opening costs and acquisitions primarily from cash flow from operations, the proceeds of various private placement equity offerings, loans under revolving credit facilities, vendor financing, securitization of certain assets and senior debt.

During fiscal 2001, the Corporation generated $1.18 million in Adjusted EBITDA as compared to $1.13 million in fiscal 2000. The increase in Adjusted EBITDA was driven primarily by operating earnings resulting from a 65.5% increase in total revenues. Adjusted EBITDA is defined as earnings before interest, taxes, depreciation and amortization, less the Corporation's purchases of rental inventory that excludes rental inventory purchased specifically for new store openings. Adjusted EBITDA should be considered in addition to, but not as a substitute for, or superior to, operating income, net income, cash flow and other measures of financial performance prepared in accordance with Canadian generally accepted accounting principals.

Operating Activities

Net cash provided by operating activities was $3.7 million for fiscal 2001 as compared to $3.2 million for fiscal 2000. The amount remained relatively constant as compared to the prior year with increases due primarily to increased amortization and increased accounts payable due to significant rental inventory purchases in the fourth quarter of calendar 2000 versus calendar 1999. The increase was partially offset by reductions in accrued liabilities. Net cash provided by operating activities continues to be sufficient to cover capital resource and debt service needs.

Financing Activities

Net cash provided by financing activities was $1.95 million for fiscal 2001 in comparison to $917,850 in the prior fiscal year. The increase is due to greater equity placements concluded in fiscal 2001 as well as additional lease inducements received from landlords. Though proceeds from long-term debt also increased during 2001, the net effect of such proceeds was offset by even greater repayments of long-term debt made during the fiscal year.

Investing Activities

Net cash used in investing activities was $6.3 million for fiscal 2001 as compared to $4.2 million for fiscal 2000. This increase in funds used for investing activities is primarily the result of increases in capital expenditures related to rental inventory and property, furnishings and equipment purchased to support the growth in the Corporation's store base, the Corporation's increased new store development plan, and a strategic move to stock greater copy depth of product.

In June 2000, the Corporation entered into a short-term credit facility with Community Savings for a revolving line of credit in the amount of $800,000. This facility augments an existing short-term revolving facility offered through TD Canada Trust in the amount of $200,000 for an aggregate short-term revolving credit line of $1.0 million. Management believes it will be necessary to obtain greater revolving short-term facilities in order to facilitate the operations of an expanding retail network of stores. Management anticipates obtaining such expanded short-term facilities during fiscal 2002.

On March 21, 2001 the Corporation also entered into a long-term expansion credit facility (the "Facility") with Community Savings in the amount of $1.5 million. The Facility is available to the Corporation for expansion purposes only and not to fund general working capital needs. The Facility was secured by a $1.5 million deposit by the Corporation at Community Savings. In order to make draws under the Facility, certain covenants with respect to substantial completion of the store, as well as other operating and capital criteria must be met. As of May 31, 2001 the Corporation had not drawn any amount under the Facility. The Corporation, as an event subsequent, has drawn funds under the Facility, and will likely continue to do so as it proceeds with its new-build expansion program. Management believes that it is in the best interests of shareholders to use long-term debt as a means to finance the expansion of the Corporation's retail network, and, as such, management intends to commence negotiations to increase its debt facilities. There can be no assurance that the Corporation will be successful in obtaining additional long-term debt, or that if available, it will be on terms acceptable to the Corporation.

The Corporation grows its store base through internally developed and acquired stores. The Corporation opened 7 internally developed stores and acquired 5 stores during the fiscal year. During the year 2002, the Corporation intends to open approximately 25 new stores and will entertain potential acquisition transactions; however, the number of acquired stores in 2002 is anticipated to be less than the number of internally developed stores. To the extent available, new stores and future acquisitions may be completed using funds available under credit facilities, financing provided by vendors, and alternative financing arrangements such as funds raised in public or private debt or equity offerings. There can be no assurance, however, that financing will be available to the Corporation, or available on terms acceptable to the Corporation.

Working Capital Deficit

At May 31, 2000, the Corporation had a working capital deficit of $2.89 million, due to the accounting treatment of its rental inventory. Rental inventory is treated as a non-current asset under generally accepted accounting principles because it is a depreciable asset and is not an asset that is reasonably expected to be completely realized in cash or sold in the normal business cycle. Although the rental of this inventory generates the major portion of the Corporation's revenue, the classification of this asset as non-current results in its exclusion from working capital. The aggregate amount payable for this inventory, however, is reported as a current liability until paid and, accordingly, is included in working capital. Consequently, the Corporation believes that working capital is not an appropriate measure of its liquidity and it anticipates that it will continue to operate with a working capital deficit.

The Corporation believes its projected cash flow from operations, borrowing capacity with the Facility, cash on hand and trade credit will provide the necessary capital to fund its current plan of operations for the fiscal year 2002, including its anticipated new store openings. However, to fund a major acquisition program, or to provide funds in the event that the Corporation's need for funds is greater than expected, or if certain of the financing sources identified above are not available to the extent anticipated or if the Corporation increases its growth plan, the Corporation will need to seek additional or alternative sources of financing. This financing may not be available on terms satisfactory to the Corporation. Failure to obtain financing to fund the Corporation's expansion plans or for other purposes could have a material adverse effect on the Corporation.

Business Risks and Management

The video rental and home entertainment industry is very competitive. The Corporation faces a number of competitors, including larger video retail chains and smaller independent video rental outlets, music stores and video game stores. Competition exists mainly on a local basis, with main competitive factors being price, service and quality. Management continually reviews its competitors and analyzes upcoming industry trends. There can be no assurance, however, that the Corporation will be successful in addressing competitive threats or adequately assessing future industry trends.

The Corporation will face competition for consumers not only from other video rental and home entertainment outlets but also from alternative forms of entertainment, such as movie theatres, television and live entertainment events. The Corporation may also face heightened competition from emerging forms of entertainment such as digital TV, HDTV, pay-per-view satellite and entertainment available via the Internet. Management has addressed these concerns in its business plan and, accordingly, has participated in the formation of E-Trend Networks, Inc. to provide e-commerce sale and distribution of filmed entertainment, music titles and video games, as well as provide on-going development of means to mitigate the risks associated with the evolution of the Internet as a means of competitive distribution. There can be no assurance that the Corporation will be successful in its efforts to mitigate the effect of technology on its existing revenue streams.

The Corporation has developed a business strategy targeting the secondary retail markets located in communities of approximately 5,000 - 10,000 people. The strength of the local economy in these types of communities typically depends upon the strength of a smaller number of key industries. If the major sustaining industry in one of these communities is negatively affected, the strength of the entire local economy will be negatively affected and the amount of disposable income of the residents in that particular community will decrease. Consequently, a store operated by the Corporation in that location may be negatively affected.

The Corporation intends to further increase the number of stores that it operates. The start-up costs associated with establishing a new store are significant. The Corporation has calculated that it will cost approximately $225,000 to establish each new store location (and up to $275,000 for each full product mix VHQ Entertainment store). Such costs may increase as the Corporation introduces new concept retail stores in an effort to match competitor offerings. There is no assurance that the Corporation will be able to obtain adequate financing or adequate cash flows from operations to cover the projected start-up costs of establishing a new store location.

In order to gain efficiencies generated by economies of scale, the Corporation must open a larger number of stores across a geographically dispersed area. The Corporation must rely initially upon outside sources of capital to finance start-up costs associated with the opening of new stores as current cash flows alone are not sufficient to fund new store openings in the numbers anticipated by the Corporation. In the event the Corporation is not successful in raising additional capital to open new stores, the Corporation will not be able to achieve anticipated efficiencies or pricing structures, all of which could have a material adverse impact on operations and profitability. For additional risks, please refer to the section entitled "Risks Related to the Corporation's Business" in the VHQ Entertainment Inc. Annual Information Form, dated October 1, 2001. The Annual Information Form can be viewed, along with the Corporation's other public filings, at www.sedar.com.

Outlook

As Management, we are proud of the accomplishments we have achieved. Over the space of a few short years, the Corporation has grown substantially and has transitioned itself from a local video store to a destination of choice for home entertainment. Although the capital markets have been tough on all market segments, we are confident that VHQ Entertainment is well positioned both financially and operationally to continue its growth throughout 2002. Where many industries fear economic downturn, VHQ Entertainment shines as a low-cost alternative to family home entertainment. Management believes it will not only survive this current economic climate but indeed thrive within it.

Management is buoyed by the success of our recent conversion to VHQ Entertainment and is pleased with the financial results achieved by its full product mix stores. The Corporation has resolved to continue to diversify its product mix in an effort to further mitigate risk.

Calendar 2000 proved to be a banner year for video and home entertainment as all classes of products the Corporation sells (filmed entertainment, music, and video games) achieved record-breaking sales results. The industry is strong and growing, as is the demand for home entertainment. The advent of DVD has created substantial opportunity for the Corporation as DVD emerges as the fastest adopted consumer technology in history. DVD has launched a renewed interest in the consumer to rent and buy movies, and Management expects this trend to continue and become even more dominant after the 2001 Christmas season. Additionally, with the convergence of media platforms towards DVD, Management expects that greater opportunities will become available to market products to consumers through their entire demographic profile – video games to teens and pre-teens, music to teens and young adults and movies to all age segments. As video gaming becomes more mainstream, it is likely consumers will use gaming hardware to also play movies, listen to CD and DVD formatted music and access the Internet – this convergence of functionality into a single piece of hardware generates opportunity for VHQ Entertainment.

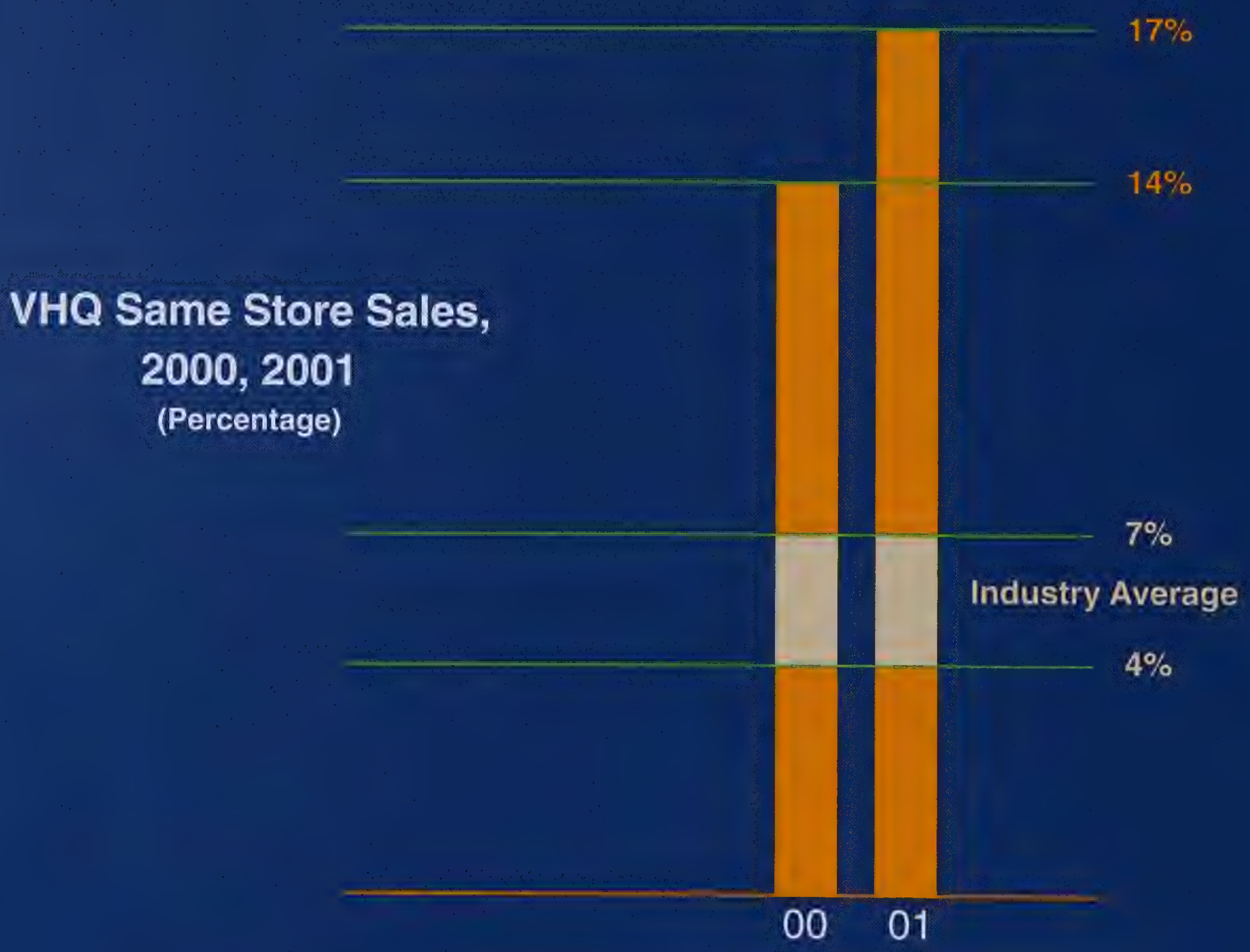
The Corporation will continue its efforts to make its retail stores a destination for shoppers and, in doing so, Management believes the risks associated with being a single source retailer are minimized. Management also has several initiatives underway to enhance the efficiencies and to streamline the operations of its businesses, and the Corporation will continue to focus on realizing opportunities to increase the profitability within all its operations. As the Corporation expands it will continue to benefit from better supplier pricing and terms, as well as the advantages associated with certain economies of scale.

Management believes margins will remain stable within the industry for the foreseeable future, however, as the Corporation continues its expansion strategy and existing stores continue to develop mature revenue streams, significant top line revenue growth is anticipated. Overall, Management is excited about the potential for expanding the Corporation's retail reach into new geographic regions. Critical mass will soon permit the Corporation to take advantage of mass marketing through radio and television. This step will provide much of the brand awareness that is critical to any retailer.

All said we remain confident that the Corporation is well positioned for continued growth and penetration into new markets. The video and home entertainment industry is poised for yet another record-breaking year, as are we.

"Total revenue increased 65.5% to $21.3 million for fiscal 2001 from $12.9 million for fiscal 2000. The increase was due to a number of factors, the most significant of which include (i) an increase in same-store revenues of 17%, and (ii) a 36% increase in the number of stores operating during fiscal 2001 versus fiscal 2000."

VHQ stores are enjoying industry-leading annual same store revenue growth of 17 percent, as compared to the average 4 - 7 percent growth reported by the leading competitor chains.



Performance

I need a secure investment that is poised for growth and stability over the long term. I have college to think about, you know.

VHQ stores are enjoying industry-leading annual same store revenue growth of 17 percent, as compared to the average 4 - 7 percent growth reported by the leading competitor chains.

Join us ...

VHQ Entertainment Annual and Special Meeting of Shareholders

November 15, 2001
Famous Players Park Plaza Theatre,
5214 - 47th Avenue
Red Deer, Alberta

"Meet and Greet" from 6:00 to 7:00 pm
Annual General Meeting from 7:00 to 8:30 pm
Special movie presentation to follow at 8:30 p.m.

Performance

We're pleased to report that 2001 was another record year of growth for VHQ, as the company continued a strategic approach that has diversified our operations and positioned us for continued success. With a strong management team dedicated to building the VHQ brand, we are a solid company with a bright future. This is why investors choose VHQ.

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements and information included in this Annual Report have been prepared by the management of the Corporation who are responsible for the consistency, integrity and objectivity of such statements. The Corporation maintains appropriate systems of internal control, policies and procedures to ensure that its reporting practices, accounting and administrative procedures are efficient and of high quality, consistent and of reasonable cost.

The consolidated financial statements have been examined by Collins Barrow, Chartered Accountants. The external auditors' responsibility is to express a professional opinion on the fairness of management's consolidated financial statements. The Auditors' Report outlines the scope of their examination and sets forth their opinion.

The consolidated financial statements have been reviewed and approved by the Board of Directors.

Trevor M. Hillman	Gregg C. Johnson
President & Chief Executive Officer	Executive Vice President

Auditors' Report

To the Shareholders of
VHQ Entertainment Inc.

We have audited the consolidated balance sheet of VHQ Entertainment Inc. as at May 31, 2001 and the consolidated statement of earnings and retained earnings (deficit) and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at May 31, 2001 and the results of its operations and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at May 31, 2000 and for the year then ended were audited by other auditors who expressed an opinion without reservation on these statements in their report dated July 31, 2000.

September 10, 2001
Red Deer, Alberta

Collins Barrow
Chartered Accountants

Consolidated Balance Sheet

	May 31, 2001 $	May 31, 2000 $
ASSETS		
Current		
Cash	155,371	238,635
Accounts receivable	237,583	354,747
Inventory	1,561,352	789,971
Note receivable	-	884,009
Prepaid expenses and deposits	189,286	201,553
	2,143,592	2,468,915
Investment	-	1,886,851
Capital assets *[notes 4 and 5]*	8,575,627	6,827,334
Goodwill net of amortization of $610,700 (2000 - $249,399)	3,018,749	3,369,994
	13,737,968	14,553,094
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness *[note 6]*	800,556	69,231
Accounts payable and accrued liabilities	3,977,617	2,860,675
Current portion of lease inducement	65,744	25,212
Current portion of long-term debt *[note 7]*	158,750	62,924
	5,002,667	3,018,042
Deferred lease inducement	291,676	108,684
Long-term debt *[note 7]*	110,794	233,996
Due to related company *[note 11]*	493,578	361,331
Future income taxes *[note 9]*	748,000	2,465,000
Commitments *[note 12]*		
Shareholders' equity		
Share capital *[note 8]*	7,626,499	6,087,766
Retained earnings (deficit)	(535,246)	2,278,275
	7,091,253	8,366,041
	13,737,968	14,553,094

See accompanying notes

Approved on behalf of the Board:

Trevor M. Hillman
Director

Gregg C. Johnson
Director

Consolidated Statement of Earnings and Retained Earnings (Deficit)

	For the year ended May 31, 2001 ($)	For the year ended May 31, 2000 ($)
Revenue		
Rentals	16,579,831	10,205,031
Product Sales	4,750,636	2,679,821
	21,330,467	12,884,852
Cost of Sales		
Rentals	4,371,365	2,076,676
Product Sales	3,665,497	2,187,754
	8,036,862	4,264,430
Gross Margin	13,293,605	8,620,422
Operating Costs and Expenses		
Store Operating Expenses	9,371,740	5,525,630
General and Administrative	2,318,520	1,956,710
Amortization of Intangibles	361,934	246,288
	12,052,194	7,728,628
Operating Income	1,241,411	891,794
Interest Expense (net)	(119,649)	(151,497)
Video Limited Partnership Disbursements	(1,509,565)	(732,990)
Income (loss) before the following:	(387,803)	7,307
Write-down of Investment *[note 3]*	(1,886,851)	-
Write-down of Capital Assets *[note 4]*	(2,255,867)	-
Non-controlling Interest	-	114,572
Equity Loss of Investment	-	(268,249)
Gain on Dilution of Investment	-	2,452,188
Gain on Disposal of Assets	-	1,297,049
Income (Loss)	(4,530,521)	3,602,867
Future Income Taxes (Recovery)	(1,717,000)	1,500,000
Net Income (Loss)	(2,813,521)	2,102,867
Retained earnings, beginning of the period	2,278,275	175,408
Retained earnings (deficit), end of the period	(535,246)	2,278,275
Earnings (loss) per share *[note 10]*	(0.24)	0.21
Adjusted EBITDA *[note 14]*	1,182,376	1,127,838

See accompanying notes

Consolidated Statement of Cash Flows

	For the year ended May 31, 2001 $	For the year ended May 31, 2000 $
CASH WAS PROVIDED BY (USED FOR):		
Operating activities		
Net income (loss) for the period	(2,813,521)	2,102,867
Add (deduct) items not affecting cash:		
Amortization of capital assets and intangibles	3,329,413	2,067,683
Amortization of lease inducement	(109,876)	(21,042)
Write-down of capital assets *[note 4]*	2,255,867	-
Write-down of investment *[note 3]*	1,886,851	-
Non-controlling interest	-	(114,572)
Gain on dilution of investment	-	(2,452,188)
Gain on disposal of assets	-	(1,297,049)
Equity loss of investment	-	268,249
Future income taxes (recovery)	(1,717,000)	1,500,000
	2,831,734	2,053,948
Net change in non-cash components of working capital	721,186	1,185,679
	3,552,920	3,239,627
Financing activities		
Proceeds from issue of share capital, net of issuance costs	1,538,733	509,596
Proceeds from long-term debt	125,000	74,065
Repayment of long-term debt	(183,626)	(89,369)
Lease inducements received	333,400	62,227
Advance from related company	132,247	361,331
	1,945,754	917,850
Investing activities		
Acquisitions *[note 2]*	(225,000)	(2,750,000)
Dilution of subsidiary		406,345
Issuance of note receivable	-	(925,000)
Repayment of note receivable	884,009	40,991
Proceeds from disposal of capital assets	-	4,000,000
Purchase of capital assets	(6,972,272)	(4,989,913)
	(6,313,263)	(4,217,577)
Decrease in cash for the period	(814,589)	(60,100)
Cash, beginning of the period	169,404	229,504
Cash (Bank Indebtedness), end of the period	(645,185)	169,404
Cash interest paid	116,415	145,892
Cash taxes paid	-	-
Cash (Bank Indebtedness) consists of the following:		
Cash	155,371	238,635
Bank Indebtedness	(800,556)	(69,231)
	(645,185)	169,404

See accompanying notes

Notes to the Consolidated Financial Statements

May 31, 2001 and 2000

1. Significant Accounting Policies

The consolidated financial statements of the Corporation have been prepared in accordance with accounting principles generally accepted in Canada and include the accounts of the Corporation and its subsidiaries. Because a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period necessarily involves the use of estimates and approximations which have been made using careful judgment. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

Description of business

The Corporation is incorporated under the Canadian Business Corporations Act and through its subsidiaries operates video and home entertainment stores in Canada.

Basis of consolidation

These consolidated financial statements include the accounts of the Corporation and its wholly owned subsidiaries: Integrated Retail Corp., Safiqa Holdings Ltd., Star Vision Enterprises Inc., and 705556 Alberta Ltd.

The excess of the acquisition costs of investment in subsidiaries over the Corporation's proportionate share of the underlying value of the net assets at the date of acquisition represents goodwill, and is amortized over periods not exceeding 10 years. The value of goodwill, and any impairment of that value, is assessed by reference to cash flows, operating income and estimation of fair value.

Inventory

Inventory, consisting primarily of filmed entertainment on VHS and DVD, video games and CD music for resale, studio merchandise, videogaming accessories and confectionery items, is valued at the lower of cost and net realizable value.

Revenue recognition

Revenues are generally recognized at the time of sale or rental. Rental revenue includes the rental for periods of less than seven days of VHS, DVD and video games, as well as the sale of previously viewed/used VHS, DVD and video games.

Advertising expenses

Advertising costs are expensed as incurred.

Capital assets

Capital assets are recorded at cost. Amortization is provided using the following rates and methods to amortize the costs, net of any residual or salvage values, over their estimated useful lives:

Canopies and signs	20% straight line
Equipment and fixtures	10% declining balance
VCR's, TV's and game players	30% declining balance
VHS, DVD and video games	12 month straight line
Computer hardware	30% declining balance
Computer software	20% declining balance
Leasehold improvements	Over term of the lease plus one renewal period
Logo and jingle	3 years straight line
Uniforms	2 years straight line

During the fiscal year, the Corporation changed its method of amortization of its rental product (VHS, DVD, and video games). This method accelerates the rate of amortization and was adopted as a result of an industry trend towards significant increases in copy depth availability from movie studios and revenue sharing agreements, that have resulted in earlier satisfaction of consumer demand, thereby, accelerating the rate of revenue recognition. As a result of the change, the Corporation has revised its estimate of the useful life of its rental product to a twelve-month period of amortization from a twenty-four month period, and has revised the salvage value of its VHS and DVD movies and video games from $7 per unit to $5, $10, and $15, respectively.

Future income taxes

Under the liability method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Financial instruments

Financial instruments of the Corporation consist mainly of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, due to related company, and long-term debt. There are no significant differences between the carrying values of these amounts and their estimated market values.

Stock option plan

The Corporation's stock option plan is described in note 8. Consideration paid by employees, consultants and directors on the exercise of stock options is credited to share capital. The Corporation does not record any amounts to compensation expense related to the granting or exercise of stock options.

Cash and cash equivalents

Cash and cash equivalents includes cash and bank indebtedness balances.

Segmented information

The Corporation does not disclose segmented information as the Corporation engages in and monitors only one operating segment. The Corporation's geographic segment is within the Canadian market.

2. Acquisitions

On June 15, 2000, the Corporation's wholly owned subsidiary Star Vision acquired from Raeco Holdings Incorporated, all of the assets of a video and home entertainment store operating under the name "Silver Screen Video", in Saskatoon, Saskatchewan.

On July 11, 2000, the Corporation acquired the assets of M & K Video Spot Inc., an independent video retailer operating one video store in Stony Plain, Alberta and one video store in Spruce Grove, Alberta under the name "Five Star Movies".

Assets Acquired	**Five Star Movies**	**Silver Screen Video**
Capital Assets	$425,000	$200,000
	$425,000	$200,000
Consideration		
Cash	125,000	100,000
Note Payable	125,000	-
Share Capital	175,000	100,000
	$425,000	$200,000

3. Write-Down of Investment

The Corporation holds a 40.1% (2000 – 44.18%) equity ownership in E-Trend Networks, Inc., a Delaware public corporation trading on the NASDAQ Bulletin Board under the trading symbol "ETDN". The Corporation has written down this investment resulting in a one-time charge to net income in the amount of $1,886,851.

4. Write-Down of Capital Assets

Effective May 31, 2001, the Corporation changed its estimation of the useful life and salvage values of its rental product. As a result of this change, the Corporation has revised its estimates of the useful life of rental product to a twelve-month amortization period from a twenty-four month amortization period and has reduced its estimate of the salvage value from $7 per item to $5 per VHS, $10 per DVD and $15 per video game. This change has been applied prospectively as a change in accounting estimate and resulted in a one-time write-down of capital assets in the amount of $2,255,867.

5. Capital Assets

	May 31, 2001		
	Cost $	Accumulated Amortization $	Net Book Value $
Canopies and signs	492,738	178,137	314,601
Equipment and fixtures	2,074,197	720,041	1,354,156
VCR's, TV's and game players	420,883	234,325	186,558
VHS, DVD and video games	13,468,906	7,636,718	5,832,188
Computer hardware	591,739	394,937	196,802
Computer software	374,973	134,049	240,924
Leasehold improvements	684,921	247,250	437,671
Logo and jingle	3,250	3,250	-
Uniforms	44,867	32,140	12,727
	18,156,474	9,580,847	8,575,627

	May 31, 2000		
	Cost $	Accumulated Amortization $	Net Book Value $
Canopies and signs	295,323	89,129	206,194
Equipment and fixtures	1,876,713	660,255	1,216,458
VCR's, TV's and game players	188,559	81,788	106,771
VHS, DVD and video games	8,267,602	3,697,698	4,569,904
Computer hardware	481,195	323,913	157,282
Computer software	281,010	80,173	200,837
Leasehold improvements	526,441	160,103	366,338
Logo and jingle	3,250	2,617	633
Uniforms	27,220	24,303	2,917
	11,947,313	5,119,979	6,827,334

6. Bank Indebtedness

The Corporation has two demand operating credit facilities with Canadian financial institutions providing for overdrafts which have maximum limits in the amounts of $800,000 and $200,000. The credit facilities bear interest at prime plus one percent (2001 – 7.25%) and prime plus one half of one percent (6.75%), respectively.

On March 23, 2001, the Corporation obtained a $1.5 million credit facility to be used in connection with the Corporation's new-build strategy. The credit facility bears interest at the rate of 4.5% per annum and $1.5 million of short term deposits have been pledged as security. On June 12, 2001, $400,000 of the credit facility was released to the Corporation with monthly payments of $12,398, including interest commencing August 1, 2001, bearing interest at a rate of one percent per annum above the Credit Union prime rate.

7. Long-Term Debt

	May 31, 2001 $	May 31, 2000 $
Promissory note, due on July 29, 2002 bearing interest at 9% per annum and the personal guarantee of a shareholder is pledged as collateral.	77,299	74,065
Small business loan, due in monthly installments of $5,250 including principal and interest, interest at prime plus 3% per annum, (9.25% at May 31, 2001, 2000 – 10.5%) and a general security agreement covering all assets is pledged as collateral.	160,995	205,483
Promissory note, due in monthly installments of $10,417 plus interest at 9% per annum and a general security agreement covering assets located in Spruce Grove and Stony Plain pledged as collateral.	31,250	-
Other	-	17,372
	269,544	296,920
Less current portion	158,750	62,924
	110,794	233,996

Estimated principal payments over the next three years are as follows:

	$
2002	158,750
2003	55,046
2004	55,748
	269,544

8. Share Capital

Authorized
Unlimited number of preferred shares
Unlimited number of common shares

Common shares issued	Number of Shares	$
Balance, May 31, 1999	8,497,276	2,664,170
Exercise of options	200,000	40,000
Exercise of warrants	316,575	395,719
Exercise of broker options	59,372	44,529
Issued for acquisitions	1,996,207	2,914,000
Issued for cash	25,833	33,750
Share issue costs	-	(4,402)
Balance, May 31, 2000	11,095,263	6,087,766
Exercise of options	-	-
Exercise of warrants	-	-
Exercise of broker options	-	-
Issued for acquisitions *[note 2]*	68,750	275,000
Issued for cash	366,754	1,375,289
Share issue costs	-	(111,556)
Balance, May 31, 2001	11,530,767	7,626,499

Pursuant to escrow agreements, 1,760,009 common shares are held in escrow. Of these escrowed shares, 1,383,333 will be released on September 19, 2001 and 376,676 will be released based on certain performance criteria.

Options and warrants

The Corporation has a stock option plan available to officers, directors and employees with grants under the plan approved from time to time by the Board of Directors. The exercise price of each option equals the market price of the Corporation's stock at the date of grant. The plan provides for vesting at the discretion of the Board and the options expire after five years from the date of grant.

The Corporation has issued the following stock options:

	Shares	Weighted Average Exercise Price ($)
Outstanding as at May 31, 1999	200,000	0.20
Granted during the year	1,000,000	1.51
Exercised during the year	(200,000)	0.20
Outstanding as at May 31, 2000	1,000,000	1.51
Granted during year	142,200	2.68
Exercised during year	-	-
Outstanding as at May 31, 2001	1,142,200	1.66
Options exercisable as at May 31, 2001	1,016,791	1.55

As of May 31, 2001, the Corporation has the following warrants to purchase common shares outstanding:

Warrants Outstanding	Date Issued	Date of Expiration	Exercise Price
50,000	Dec 1, 1999	Dec 31, 2001	Exercisable at $2 per share
240,205	June 28, 2000	June 28, 2002	Exercisable at $5 per share for the first year; $6 per share for the second year
110,862	Aug 31, 2000	Aug 31, 2002	Exercisable at $5 per share for the first year; $6 per share for the second year
15,666	Oct 18, 2000	Oct 18, 2002	Exercisable at $5 per share for the first year; $6 per share for the second year

9. Income Taxes

The provision for income taxes varies from the amount computed by applying the combined federal and provincial tax rates as follows:

	For the year ended May 31, 2001 $	For the year ended May 31, 2000 $
Computed income taxes (recovery) at 38.48% (2000 - 44.98%)	(1,743,344)	1,620,570
Non-deductible expenses	38,480	-
Amortization of goodwill	129,330	106,153
Dilution of investment	-	(196,723)
Gain on disposal of assets and asset write-downs	241,676	(30,000)
Investment write-down	(356,214)	-
Effect of change in expected tax rates in computing future taxes	(26,928)	-
	(1,717,000)	1,500,000

Significant components of the future tax liability are:

	For the year ended May 31, 2001 $	For the year ended May 31, 2000 $
Net book value in excess of tax pools	797,000	1,938,000
Book value of investment excess of adjusted cost base	-	565,000
Share issue costs	(49,000)	(38,000)
	748,000	2,465,000

10. Earnings (loss) Per Share

The earnings (loss) per share has been calculated based on the weighted average number of common shares outstanding for the year ended May 31, 2001 of 11,490,281 (2000 – 10,086,383). An assumed conversion of the options and warrants to purchase common shares and the resultant imputed interest savings does not have a dilutive effect on earnings (loss) per share.

11. Due to Related Company

The amount is due to E-Trends Networks, Inc., has no fixed terms of repayment, bears interest at bank prime plus one percent per annum, (8% at May 31, 2001), and is unsecured. The Corporation does not expect to repay this balance of the loan in the next year.

Included in accounts payable, is $374,839 due to Langara Distribution Inc., a wholly owned subsidiary of E-Trend Networks, Inc.

12.Commitments

The Corporation is committed to the following rental payments under leases for various premises:

	$
2002	2,823,456
2003	2,642,130
2004	2,271,338
2005	1,949,682
2006	1,799,179
Thereafter	4,450,042
	15,935,827

With respect to the above leases, the Corporation received lease inducements which are being amortized and offset against general and administrative expense over the terms of the leases.

13. Subsequent Event

On August 7, 2001, the Corporation sold $459,400 worth of Units of VHQ in a private placement. Each of the 229,700 Units of VHQ consisted of one common share of VHQ and one-half of one warrant to purchase one common share of VHQ. Each Unit was sold for $2.00 per Unit. Each common share warrant entitles the holder thereof to purchase one common share of VHQ at any time on or before August 7, 2002, at an exercise price of $2.50 per common share.

14. Adjusted EBITDA

Adjusted EBITDA is defined as earnings before interest, taxes, depreciation and amortization, less the Corporation's purchases of rental inventory that excludes rental inventory purchased specifically for new store openings. Adjusted EBITDA should be considered in addition to, but not as a substitute for, or superior to, operating income, net income, cash flow and other measures of financial performance prepared in accordance with Canadian generally accepted accounting principles.

Information

Directors and Senior Officers

Rod D. Stephen
Director and Chairman of the Board

Trevor M. Hillman
Director, President and Chief Executive Officer

Gregg C. Johnson
Director and Executive Vice President

Derrek R. Wong
Chief Financial Officer

Timothy J. Sebastian
Secretary and General Counsel

Michael D. McKelvie
Senior Vice President, Marketing and Communications

Ayaz Kara
Director and Vice President, Business Development

Marc L. Gignac
Director and Vice President Operations, Saskatchewan

Peter A. Lacey
Director

Catherine J. McDonough
Director

Principal Banks

Community Savings
Red Deer, Alberta

CIBC
Red Deer, Alberta

Auditors

Collins Barrow, Chartered Accountants
Red Deer, Alberta

Legal Counsel

Shea, Nerland, Calnan
Barristers & Solicitors
Calgary, Alberta

Transfer Agent

Computershare Trust Company of Canada
Calgary, Alberta

Trading Symbol

"VHQ" Toronto Stock Exchange

VHQ

Where Entertainment Begins!™

"VHQ" Toronto Stock Exchange

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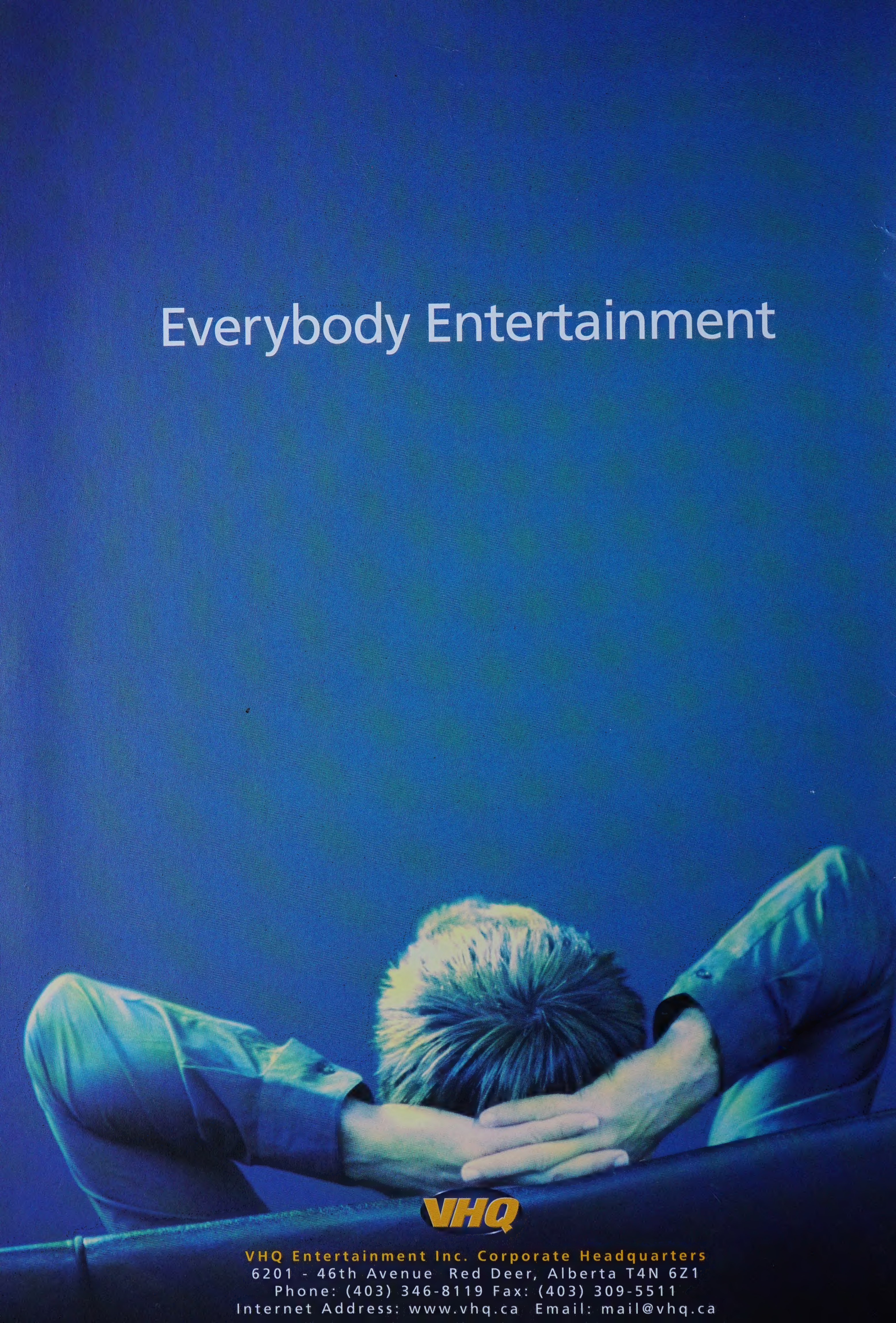
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